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September 16, 2005

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: Docket No. 3692 – Verizon RI Proposed Alternative Form of Regulation Plan

Dear Ms. Massaro:

Enclosed for filing are the original and three copies of Verizon Rhode Island's Responses to the Division's Data Requests 1-23 through 1-29.

Please be advised that certain attachments to the Responses contain proprietary and confidential business and financial information. They are therefore filed in the sealed envelope labeled "Contains Privileged Information – Do Not Release. Please place these documents in a secure, non-public file. These documents are being provided only to the Commission, and to the Division in accordance with the terms of the Protective Agreement between Verizon RI and the Division.

As always, please call me with any questions. Thank you for your attention to this matter.

Sincerely,

/s/ Alexander W. Moore

Alexander W. Moore

Enclosures
cc: Service List

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Theresa L. O'Brien
Title: Vice President – RI Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-23 Please provide a complete and legible copy of any and all Verizon alternative regulation plans and/or deregulation plans that are currently in effect for Verizon operations in the State of New York and/or in the states that comprise New England. Please provide a complete and legible copy of all regulatory body orders that approved each such alternative regulation plan.

REPLY: Attached are copies of the most recent alternative regulation orders for alternative regulation plans currently in effect in Massachusetts, Maine, Vermont, and Rhode Island. The Massachusetts DTE Order in Docket 01-31, Phase I, and the Vermont Order in Docket 6167 are available in hard copy only. New York and New Hampshire do not have alternative regulation plans.

VZ # 23

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

Verizon RI Alternative Regulation Plan	))))	Docket No. 3445

SETTLEMENT AGREEMENT

WHEREAS, Verizon New England Inc., d/b/a Verizon Rhode Island ("Verizon RI") filed a proposed Alternative Regulation Plan with the Rhode Island Public Utilities Commission on July 1, 2002, to establish the method by which the Commission will regulate the intrastate services Verizon RI offers under tariff in Rhode Island following the expiration of Verizon Rhode Island's currently effective Price Regulation Successor Plan on December 31, 2002;

WHEREAS, the Commission opened this docket and held public hearings from November 19-22, 2002, to receive public comment on the proposed Alternative Regulation Plan and thereafter received testimony or comment from the Rhode Island Division of Public Utilities and Carriers ("Division"), the Department of the Attorney General, Cox Communications, and Conversent Communications of Rhode Island, L.L.C.;[1]

WHEREAS, various members of the public, as well as the Division, Commission, and the Department of the Attorney General have expressed significant concern regarding the continued funding for the K-12 schools and libraries internet access programs, in light of the fact that Verizon RI's voluntary commitment to fund this program expires under the terms of the PRSP on December 31, 2002;

WHEREAS, the Division and Verizon RI desire to fully and finally resolve all of the disputed issues in this proceeding in a manner that is reasonable, consistent with the record, public policy, and in the best interest of Rhode Island consumers;

NOW WHEREFORE, the Division and Verizon RI (hereinafter the Parties) have reached agreement on the following terms and hereby submit this Settlement Agreement for the Commission's approval.

[1] Sprint Communications Company and Global NAPs, Inc. also intervened in this proceeding, but did not file comments or appear at the hearings.

1. Verizon Rhode Island's Alternative Regulation Plan shall be modified as set forth in the attached Appendix 1.

2. Upon approval by the Commission, effective January 1, 2003 the Alternative Regulation Plan (Appendix 1) shall be the method by which the Commission regulates the intrastate services Verizon RI offers under tariff in Rhode Island.

3. This Settlement Agreement is the result of a negotiated settlement between the Parties with respect to matters to be considered in Docket 3445. Beyond the terms hereof, this Settlement Agreement shall not be construed as evidence or serve as a precedent to any matter of fact or law in these proceedings, or in any other proceeding before the Commission, or any other state or federal regulatory body, or any state or federal court. In the event that the Commission rejects or fails to approve any part of this Settlement Agreement, the entire Settlement Agreement shall be void.

4. The Parties hereby attest that this Settlement Agreement is reasonable, in the public interest, and in accordance with state and federal law and regulatory policy.

5. If either Party in good faith believes that the other has not complied with the material terms of this Settlement Agreement, or has not acted in good faith relative to its commitments under this Settlement Agreement, or that any event has materially affected the terms and conditions upon which it has entered into this Settlement Agreement, the Party may apply to the Commission to end this Settlement Agreement.

6. This Settlement Agreement is entered into without prejudice to positions taken by Verizon RI, its parent, or affiliates, in this, or any other state, and shall not constitute precedent with respect to any such matters.

7. The terms of the Settlement Agreement are offered for settlement purposes only, and nothing in the Settlement Agreement shall be construed as a waiver by either Party of any argument that has been, or may be, asserted in any proceeding.

8. The Parties hereby acknowledge that the Commission has a continuing statutory obligation to protect the public against improper and unreasonable rates that cannot be precluded by a settlement agreement. The Commission approves this Settlement Agreement subject to its rights to review, and where required, modify rates to protect the public from rates found to be improper and unreasonable in accordance with R.I.G.L., §§ 39-1-1, *et seq.* The Commission's approval of this Settlement Agreement shall not be construed to compromise the Commission's authority to exercise these rights.

VERIZON NEW ENGLAND INC., d/b/a VERIZON RHODE ISLAND By its attorney,	RHODE ISLAND DIVISION OF PUBLIC UTILITIES AND CARRIERS By its attorney,
________________________ Keefe B. Clemons, # 6567 Assistant General Counsel 185 Franklin Street, 13th Floor Boston, MA 02110-1585	________________________ Leo J. Wold, # 3613

DATED: December 6, 2002

APPENDIX 1

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

ALTERNATIVE REGULATION PLAN

APPLICABLE TO

VERIZON RHODE ISLAND INTRASTATE OPERATIONS

The Alternative Regulation Plan (the "Plan") establishes the method by which the Rhode Island Public Utilities Commission ("Commission") will regulate the intrastate services Verizon New England Inc., d/b/a Verizon Rhode Island ("Verizon RI" or the "Company") offers under tariff in the state. The terms of the Plan are as follows:

A. Except as otherwise provided in Paragraph I, below, Primary Residence Basic Exchange rates (as described in Appendix A, Page 1) shall not be increased by more than $1.00 per line per year over the two-year period following the effective date of the Plan. Subsequent to the two-year period following the effective date of the Plan, the Rhode Island Division of Public Utilities and Carriers ("Division") reserves the right to review any proposed rate increase to Primary Residence Basic Exchange rates in the third year of the Plan.

B. Except as otherwise provided in Paragraph I, below, Residence Local Usage rates (as described in Appendix A, Page 1) shall not be increased for two years after the effective date of this Plan.

C. Except as otherwise provided in Paragraph I, below, the aggregate rates associated with all Intrastate Switched Access Services (as described in Appendix A, Page 2) shall not be increased. Rate levels of individual service elements in this category may be increased, provided that the revenue impact of those increases is equal to or less than the revenue impact of rate reductions implemented in this category, prior to or coincident with the proposed increase. Should Verizon Rhode Island desire to increase or decrease any of its switched access rates as permitted by this Paragraph, it may do so only once it has made the appropriate filing with the Commission, and the Commission has taken such action on such filing as it deems is necessary and proper.

D. All Other Retail Services - Rates and charges for all other tariffed retail services (see Appendix A, Pages 3 through 6 for a listing of all such services), and all new services introduced by Verizon RI will increase or decrease in response to market conditions. Pricing for these services will be at the discretion of the Company.

E. Prices for access to Verizon RI's unbundled network elements and interconnection with the Company's facilities and equipment, and the level of the Company's wholesale (resale) discount, will continue to be set in accordance with the Federal Telecommunications Act of 1996, as amended.

F. Revenue generated from a restructured service may not exceed the amounts applicable to the service under the pricing rules outlined in Paragraphs A, B, and C preceding. A service restructure is a change in the method by which an existing service is priced or in the terms by which an existing service is offered.

G. Lifeline Services - The Lifeline Credit will be increased by an amount equal to any increase in the Primary Residence Basic Exchange rate implemented in accordance with Paragraph A preceding.

H. Tariff Filings and Withdrawals

   1. Verizon RI may make filings incorporating tariffs to go into effect not less than thirty (30) days later unless suspended by the Commission.
   2. Verizon RI may modify the application of rate elements during the term of the Plan so long as such modifications comply with all pricing rules.
   3. The Division of Public Utilities and Carriers (the "Division") and the Commission will review these filings for compliance with the Plan and statutory requirements.
   4. Verizon RI will continue to offer all of the intrastate services provided under tariff as of the date of Commission approval of the Plan unless it petitions and receives approval from the Commission to withdraw a service.
   5. Verizon will not alter its Commission-approved local calling areas without prior Commission approval.

I. Exogenous Events - An exogenous event is one that is beyond the control of Verizon RI and that positively or negatively changes the Company's cost of providing, or its revenues from, its services. An exogenous event includes, but is not limited to:

   1. changes in tax laws;
   2. changes in Generally Accepted Accounting Principles (GAAP) that apply specifically to telecommunications or changes in the Federal Communications Commission Uniform Systems of Accounts;
   3. any Federal Communications Commission rules changes pertaining to jurisdictional separations; and
   4. regulatory, judicial, or legislative changes affecting the telecommunications industry, including rules and orders that are necessary to implement such changes.

   If the Commission finds that Verizon RI has experienced a positive or negative change in costs or revenues due to an exogenous event, it shall allow the Company to reflect the amount of the change by way of surcharge, credit or rate adjustment as appropriate. If a dispute arises over whether an event is exogenous, the burden of proof lies with the party proposing the recovery or reduction. Rate adjustments resulting from Exogenous Changes will be applied to services on a cost causation basis whenever possible. Verizon RI shall reduce by $1.0 million the cumulative total amount of any positive changes in costs or revenues (meaning increases in the Company's cost of providing its services or reductions in the Company's revenues from such services) due to exogenous events in the year that it initially seeks approval for said exogenous changes. Verizon shall not reduce the cumulative total of exogenous changes that result in rate reductions in the year it initially seeks approval for said exogenous changes. Verizon RI's recoverable Exogenous Changes, if any, shall in no event exceed $2.5 million annually. Any Exogenous Changes in excess of $2.5 million during any one year may be carried forward to the year immediately following and aggregated with that following year's Exogenous Changes, if any, still subject to the $2.5 million annual cap. Notwithstanding the previous sentence, if Verizon RI claims Exogenous Changes in excess of $ 2.5 million in any year as a result of an increase in state or local taxes, Verizon RI may apply to the Commission to increase rates to recover those costs. By October 31st of each year of the Plan, Verizon will certify with the Rhode Island Public Utilities Commission whether or not it has experienced an exogenous event in the previous twelve months. If it has experienced an exogenous event(s), the Company will provide the necessary justification for any increase or decrease in its rates.

J. Appendix B represents the retail Quality of Service Plan - The Annual Service Quality Adjustment Factor will remain at .5%. At the conclusion of each calendar year, the Company will incur a performance payment obligation equal to one twelfth of .5% of total annual retail revenue for each month of the year in which the Plan's requirements were not met. The performance payment obligation will be paid as an annual bill credit to each residence and business line in service at the time of the payment.

K. Under the Plan, Verizon RI has the discretion to adjust its depreciation rates; however, the composite depreciation rate may not fall below the composite rate in effect as of January 1, 1994. Verizon RI will report to the Commission and the Division any changes it makes in its composite depreciation rates. The report will be accompanied by a schedule detailing changes in depreciation rates, service lives, and net book value for each category of depreciable plant assets.

L. Verizon RI or the Division may petition the Commission to modify any of the terms or conditions of the Plan: (i) to reflect the impact of relevant provisions or decisions, enacted or issued subsequent to the Commission's approval of the Plan, of federal or state legislative, judicial or administrative bodies of competent jurisdiction; or (ii) to seek a less structured form of regulation or deregulation of its operations based upon changes in market conditions. In any proceeding, the burden shall be on the Company to establish the reasonable basis for the modification.

M. In order to provide a sufficient period of time to investigate and determine an equitable mechanism by which to fund internet access for Rhode Island K-12 schools and libraries, Verizon RI agrees to continue its voluntary subsidization of that program for a period commencing with the approval of this agreement and ending December 31, 2004. Verizon RI's commitment to this endeavor shall not exceed $4.0 million for the period from January 1, 2003 to December 31, 2004.

N. Verizon RI will file annual financial reports with the Commission by April 15th in the same form as it did under the prior Price Regulation Plan. In addition, Verizon RI agrees to provide additional information the Commission or Division may reasonably request, subject to appropriate proprietary arrangements, that would assist the Commission in analyzing and evaluating Verizon RI's financial results under the Plan.

O. Price Floor
At such time as Verizon RI files any tariff proposing decreases in any of its retail rates for services currently offered or proposing initial retail rates for new offerings, Verizon RI will include with such filing a certification that such reduced rates or initial rates are not less than the Long Run Incremental Cost (LRIC) of such services or offerings. Upon the subsequent request of the Commission or the Division, Verizon RI shall file the necessary support documentation to confirm that such reduced or initial rates meet said price floor. In all proceedings concerning Verizon RI's compliance with the price floor, Verizon RI retains the burden of proving that its proposed prices exceed the appropriate LRIC price floor.

P. Term
The term of this Plan shall be three years. All pricing rules for services included in Paragraph A above will remain in effect for three years following Commission approval of the Plan (at which time they shall expire). On or before July 1, 2004, Verizon RI shall file with the Commission and the Division its proposal solely with respect to its proposed rate increases (up to $1.00) per line and/or decreases for Primary Residence Basic Exchange (Paragraph A) for the third year of this Plan (calendar year 2005). The Division shall file a recommendation with the Commission on or before September 1, 2004. Verizon RI may request the Commission to decide at open meeting, whether to accept the filing or hold hearings and will further request that the Commission issue a written order with respect to this request no later than December 31, 2004. Verizon RI and the Division agree that no new rates will go into effect without a Commission order. All other provisions of the Plan that do not contain specific end dates will expire three years after the effective date of the Plan.

LIST OF SERVICES

Residential Basic Exchange Services* Subject to Paragraphs A and B of the Alternative Regulation Plan	
	PUC 15 Tariff Reference: Part M, Section 1
Lifeline support	1.1.3
Premises work charges-Residence only	1.3.1
Temporary Suspension of Service	1.3.2
Other Service Charges-Residence (includes restoral & suspension of service as well as jacks, rewire, etc.)	1.3.2
Basic Exchange Services & Local Usage-Msd & Unlimited-Residence	1.5.1
Basic Exchange Services & Local Usage-Msd & Unlimited-Composite Statewide-Residence	1.5.2
Basic Exchange Services-Superceded-Unlimited-Residence	1.5.3
Basic Exchange Services-Other-Trunk lines and S&E-Residence	1.5.4
Basic Exchange Services-Residence Other-S&E Charges	1.5.4
Dormitory Communications Service	1.5.5
Public Emergency Call Receiving Service	1.12.1

*** Applies to residential primary lines only**

LIST OF SERVICES

Services Subject to Paragraph C of the Alternative Regulation Plan	
	Tariff Reference:
Intrastate Switched Access	P.U.C. No. 20

LIST OF SERVICES

Residential Services
Subject to Paragraph D of the Alternative Regulation Plan

	PUC 15 Tariff Reference: Part M, Sect. 1
Residential Basic Service – Additional Lines only	1.5.1 – 1.5.4
Directory Listing Service-Nonpub & Nondirectory-Residence only	1.5.6
Directory Listing Service-Additional Listing/Dual Name-Residence only	1.5.6
Directory Listing Service-Change Listing-Residence only	1.5.6
Directory Assistance Service-Residence only	1.5.7
Busy Line Verification and Busy Line Interrupt-Residence only	1.5.9
Custom Calling Services-Residence only	1.7.1
Intellidial-Residence only	1.7.11
Curb-A-Charge-Residence only	1.7.11
Distinctive Ringing-Residence only	1.7.14
Phonesmart Features-Residence only	1.7.15
Voice Dialing Service-Residence only	1.7.16
MTS-Residence only	1.9.1
Incremental Charges-Residence only	1.9.1
Call Completion Platform Service-Residence only	1.9.3
Selective Calling Service-Residence only	1.10.1
Rhode Island Statewide Calling Service	1.10.2
Sensible Minute Plan	1.10.3
Enhanced Universal Emergency Number Service (E911, PSAP, data lns, common equip, etc.).	1.12.2
Value Pack	1.15.1
Local Package	1.15.2
Multiline Package Discount (ValuePack & Local Pkg.)	1.15.3

LIST OF SERVICES

Other Services
Subject to Paragraph D of the Alternative Regulation Plan

	PUC 15 Tariff Reference: Part M, Sect. 1
Payment Plans	1.1.2
Construction	1.2.1
Premises Work Charges-Business only	1.3.1
Other Service Charges-Business (includes restoral & suspension of service as well as jacks, rewire, etc.)	1.3.2
Protection Equipment for Services to Power Stations	1.4.1
Connecting Arrangements	1.4.2
Basic Exchange Services & Local Usage-Msd & Unlimited-Business	1.5.1
Basic Exchange Services & Local Usage-Msd & Unlimited-Composite Statewide-Business	1.5.2
Basic Exchange Services-Superceded-Unlimited-Business	1.5.3
Basic Exchange Services-Other-Trunk lines and S&E charges-Business	1.5.4
Joint User Service-PASL & Measured/Unlimited	1.5.5
Directory Listing Service-Nonpub & nondirectory-Business only	1.5.6
Directory Listing Service-Additional Listing-Business only	1.5.6
Directory Listing Service-Change Listing-Business only	1.5.6
Directory Assistance Service-Business & PASL only	1.5.7
Verizon RI Call Connect Service	1.5.8
Busy Line Verification and Busy Line Interrupt-Business only	1.5.9
Business Link	1.5.10
N-411	1.5.11

LIST OF SERVICES

Other Services, continued Subject to Paragraph D of the Alternative Regulation Plan	
	PUC 15 Tariff Reference: Part M, Sect. 1
Custom Calling Services-Business only	1.7.1
Remote Call Forwarding	1.7.2
Special Reverse Charge Toll Service	1.7.3
Line Hunting Service	1.7.4
Reference of Calls	1.7.5
Stop Hunt Arrangement	1.7.6
Make Busy Arrangement	1.7.7
Toll Restriction	1.7.8
Signal Line Filter	1.7.9
Curb-A-Charge Service	1.7.10
Intellidial-Business only	1.7.11
Pulsenet Alert Transport	1.7.12
SMDI	1.7.13
Distinctive Ringing	1.7.14
Phonesmart Features-Business only	1.7.15
Voice Dialing Service-Business only	1.7.16
Custom Redirect Service	1.7.17
PASL	1.8.1
PAL	1.8.2
PAL Curb-A-Charge	1.8.3
MTS-Business & Coin	1.9.1
Incremental Charges-Business only	1.9.1
Information Delivery Service	1.9.2
Call Completion Platform Service-Business only	1.9.3
Selective Calling Service-Business only	1.10.1
Dedicated Toll Free Service	1.11.1
Toll-free Service	1.11.2

LIST OF SERVICES

Other Services, continued **Subject to Paragraph D of the Alternative Regulation Plan**	
	PUC 15 Tariff Reference: Part M, Sect. 1
Direct Inward Dialing (DID)	1.12.3
Automatic Identification of Outward Dialing (AIOD)	1.12.4
Toll Access Trunks	1.12.5
Toll Diversion	1.12.6
Trunk Multipling Arrangement	1.12.7
Toll Billing Info	1.12.8
Special CO Term Equipment for PBX	1.12.9
Secretarial Concentrator	1.12.10-11
Service through miscellaneous Common Carriers	1.12.12
Group Alerting Service	1.12.13
CO-LAN	1.12.14
PS/ALI Trunks	1.12.15
Corporate Rewards	1.15.4
Worksmart Packages (CCS / Phonesmart)	1.15.5
Private Line Services are all business services, which are subject to Paragraph D	PUC 15, Part M, Section 2
Digital Communications Services are all business services, which are subject to Paragraph D	PUC 15, Part M, Section 3
Advanced Data Services are all business services, which are subject to Paragraph D	PUC 15, Part M, Section 4
Centrex Services are business services, which are subject to Paragraph D	PUC 15, Part M, Section 8

VERIZON RHODE ISLAND
QUALITY OF SERVICE PLAN

The Verizon RI Quality of Service Plan consists of two major components: a report of the Quality Service Standards of major service indicators and a Service Quality Index ("SQI").
Each month, Verizon RI will provide reports that reflect service performance in three major categories: Installation, Maintenance and Operator Services. In each of the major categories, there are reports on specific service items. All of the service items except Customer Trouble Reports per 100 lines are reported on a statewide basis. The Customer Trouble Reports per 100 Lines service measurement is reported on an individual exchange basis; that is, for each individual central office in the state. Each item will have two Quality Performance Levels against which they will be measured: Surveillance and Action. The categories, items, and Quality Performance Levels are listed and defined in Parts A and B of this attachment.

The Service Quality Index is a scorecard of the service performance of Verizon RI. It consists of the seven statewide service items and the 10 Customer Trouble Reports per 100 Lines Service items. The SQI is determined monthly. The seven statewide service items are the same every month. In addition, each month a group of ten alternating central offices are measured, and their Customer Trouble Report Rates are included in the SQI. Each of Rhode Island's 30 central offices is measured once per quarter.

The SQI is developed using a point system based on the performance levels shown on Part A. Each month, the 17 service items (the 7 statewide items and the 10 Customer Trouble Report Rates) are compared to the Surveillance and Action Levels for each item. If the performance level is better than the Surveillance Level, that item is assigned full credit, which is either 2 or 4 points depending on the item. If the performance level is at the Surveillance level, or falls between the Surveillance and Action Levels, that item is assigned partial credit of 1 or 2 points, depending on the item. If the performance level is at or worse than the Action Level, the item is assigned no points. This scoring is detailed in Part A.

Each month, the maximum value of the SQI is 40 [(14 items x 2 points) + (3 items x 4 points)]. A passing monthly score is 28. At the conclusion of each calendar year the Company will be required to issue a bill credit ("performance payment obligation") if it did not meet the plan's requirements in any of the preceding 12 months. The performance payment obligation will be one-twelfth of .5 percent of total annual retail revenue for each month of the year in which the plan's requirements were not met. The performance payment obligation will be paid as an annual bill credit on each residence and business line in service at the time of the payment. In addition, there will be further monitoring of Verizon RI's performance in three repair/maintenance areas: Out of Service for 24 Hours, Missed Repair Appointments, and Repair Service Answer Time. If the Company receives 0 points in at least 2 of these three service categories for consecutive months, the Company will incur a performance payment obligation of one-twelfth of .5% of total annual retail revenue. This performance payment obligation is assessed in addition to any incurred based on the Company's performance in the SQI. However, the total annual service quality performance payment obligation incurred by Verizon RI cannot under any circumstances exceed .5% of total annual retail revenue.

Months in which the SQI falls below 28 or Verizon RI receives 0 points in two of the three maintenance/repair areas because of events beyond the control of the Company, such as natural disasters, labor disputes, embargoes, requirements imposed by regulation or decree of any governmental entity, or acts of public enemy, will be excluded from the evaluation period.

VERIZON RHODE ISLAND
QUALITY OF SERVICE PLAN

Scoring of Service Quality Indices

New Installations Orders not Completed within 5 working days (%) Surveillance 10.8; Action 12.15	Under 10.8 10.8-12.14 12.15 or over	2 Points 1 Point 0 Points
Installation Appointments Missed (%) Surveillance 1.8; Action 2.25	Under 1.8 1.8 – 2.24 2.25 or over	2 Points 1 Point 0 Points
Out of Service > 24 hours (%) Surveillance 31.5; Action 34.2	Under 31.5 31.5 – 34.19 34.2 or over	4 Points 2 Points 0 Points
Repeat Repair Reports (%) Surveillance 10.5; Action 13.3	Under 10.5 10.5 – 13.29 13.3 or over	2 Points 1 Point 0 Points
Repair Appointments Missed (%) Surveillance 11.7; Action 14.4	Under 11.7 11.7 – 14.39 14.4 or over	4 Points 2 Points 0 Points
Repair Service Answer Time (sec.) Surveillance 14; Action 17	Under 14.0 14.0 – 16.9 17.0 or over	4 Points 2 Points 0 Points
Directory Assistance Answer Time (sec.) Surveillance 4; Action 5	Under 4.0 4.0 – 4.9 5.0 or over	2 Points 1 Points 0 Points
TOTAL POINTS AVAILABLE FOR SQIs/Month		**20 Points**
Customer Trouble Reports per 100 lines on an individual wire center basis Surveillance 3.5; Action 4.5	Under 3.5 3.5 - 4.49 4.5 or over	2 Points 1 Point 0 Points
TOTAL CENTRAL OFFICE POINTS AVAILABLE (Assumes 10 Cos per month are reviewed)		**20 Points**
TOTAL POSSIBLE POINTS PER MONTH		**40 POINTS**

For each month the Company fails to achieve 28 points, the required bill credit will be one-twelfth of .5 percent of total annual retail revenue.

VERIZON RHODE ISLAND
QUALITY OF SERVICE PLAN

DEFINITIONS

INSTALLATION SERVICE ITEMS

PERCENT OF NEW INSTALLATION ORDERS NOT COMPLETED WITHIN FIVE WORKING DAYS -
This standard measures the percent of appointed residence and simple business basic exchange service installation requests for new or transferred service that are not completed within five working days. Requests for telephone exchange service shall be counted when the order is received at the installation center. Orders requiring the customer to meet specific requirements will be counted from the time the requirements have been met.

PERCENT OF MISSED INSTALLATION APPOINTMENTS -
This standard measures residence and business customer initiated service orders for installation of local exchange service with a specific commitment date. Results are calculated by dividing the cumulative number of missed appointments for Company reasons in the report month by the total installation orders that month.

MAINTENANCE SERVICE ITEMS

CUSTOMER TROUBLE REPORTS PER 100 LINES ON AN INDIVIDUAL WIRE CENTER BASIS -
This standard measures customer trouble reports to Verizon RI repair centers. Reports are recorded by exchange for residence, business and public telephone services. Trouble reports for special services and exchange access services are not included. Reports are accumulated by exchange and divided by the number of customer lines (expressed in hundreds of lines) to calculate the Exchange Report Rate.

PERCENT OUT OF SERVICE 24 HOURS –
This standard measures the portion of residence, basic business and public telephone service not repaired by the Company within 24 hours (clearance times are measured on a continuous clock basis) of receipt.

PERCENT REPEAT REPAIR REPORTS -
This standard measures the percent of residence, business, and public exchange service trouble reports received within 30 days from the dates on which earlier reports had been cleared on the same lines.

PERCENT REPAIR APPOINTMENTS MISSED (COMPANY REASONS) -
This standard measures the percent of residence, business, and public exchange service trouble reports which have not been cleared on or before the initial negotiated appointment time, the customer having met any specific requirements.

VERIZON RHODE ISLAND
QUALITY OF SERVICE PLAN

DEFINITIONS, continued

MAINTENANCE SERVICE ITEMS, continued

REPAIR SERVICE AVERAGE ANSWER TIME -
This standard measures the average speed of answer of calls to the Repair Service Center Automatic Call Distribution System.

OPERATOR SERVICES SERVICE ITEM

DIRECTORY ASSISTANCE AVERAGE ANSWER TIME -
This standard measures the average speed of answer of calls to the Directory Assistance Service Automatic Call Distribution System.

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: VERIZON-RHODE ISLAND'S :
ALTERNATIVE REGULATION PLAN : DOCKET NO. 3445

REPORT AND ORDER

I. INTRODUCTION

New England Telephone ("NET") operated under traditional rate of return regulation until 1989. In 1989, the Rhode Island Public Utilities Commission ("Commission") altered NET's regulatory structure by approving a stipulation that permitted NET to have earnings sharing for a three-year period. After a comprehensive review of telecommunicatons in Rhode Island, the Commission approved a four year Price Regulation Trial ("PRT") in which NET was permitted certain pricing flexibility. In 1996, the Commission approved a Price Regulation Plan ("PRP") to regulate NYNEX, NET's successor. The PRP eliminated earnings sharing but implemented a service quality adjustment factor ("SQAF"). In 2000, the Commission approved a Price Regulation Successor Plan ("PRSP") for Bell Atlantic-Rhode Island ("BA-RI"), NYNEX's successor. The PRSP continued the regulatory framework of PRP but included additional commitments by the company such as: an increase in data network access funding of school and libraries, a Lifeline credit for low-income customers, a $5 million refund to residential customers, and expansion of calling areas. According to Verizon-Rhode Island ("VZ-RI"), BA-RI's successor, the PRSP would expire on December 31, 2002 and therefore on July 1, 2002, VZ-RI filed its proposed Alternative Regulation Plan ("ARP") for effect January 1, 2003.

II. VZ-RI DIRECT TESTIMONY

On July 1, 2002, VZ-RI submitted pre-filed testimony in support of its ARP by the following: Theresa L. O'Brien, VZ-RI's Vice-President of Regulatory Affairs, Arthur D. Silvia, Director for VZ-RI, and Dr. William Taylor, an outside consultant. In her testimony, Ms. O'Brien initially stated that since the passage of the Telecommunications Act of 1996 ("Act"), there is significant competition in the Rhode Island telecommunications market through resale, unbundled network elements ("UNEs") and through a competitor's own facilities. She noted that there are no barriers to entry or exit, and pointed out the Cox Communications ("Cox"), a cable company, is offering telephone service in 34 out of 39 cities and towns in Rhode Island. In recognition of this new competitive marketplace, VZ-RI proposed its ARP which is a step toward full market-based price regulation.[1]

Ms. O'Brien summarized the ARP. She stated that the ARP allowed VZ-RI to increase primary basic residential service by no more than $2 per month per year for the first two years of the plan after which, VZ-RI can raise the price at its discretion. She noted that changes in price for intrastate-switched access service must be revenue neutral. Also, Ms. O'Brien stated that for all other retail services or new services, VZ-RI

[1] VZ-RI Ex. 2 (O'Brien's direct testimony), pp. 4-5.

would have the discretion to set the price. However, all wholesale obligations under the Act such as the prices for UNEs, interconnection and the resale discount would be determined by the Commission as provided for under the Act.[2]

In addition, Ms. O'Brien discussed other aspects of the ARP. Ms. O'Brien stated that VZ-RI will increase the Lifeline credit in an amount equal to any increase in primary basic residential service. Also, the ARP includes a component for exogenous events that cannot exceed $2.5 million annually. In addition, Ms. O'Brien noted that since 1992 VZ-RI has solely funded the schools and libraries data network access program. She suggested that funding for the program should be borne by all telecommunications carriers in the State, but in the interim VZ-RI would continue its funding of the program in an amount not to exceed $1 million, until June 30, 2003 if the ARP is approved.[3]

Ms. O'Brien discussed VZ-RI's Service Quality Plan ("SQP"). Ms. O'Brien argued there is no need for a SQP because competition is sufficient to maintain service quality and noted that VZ-RI's competitors are not subject to service quality standards. Ms. O'Brien stated that if the Commission were to require a SQP it should retain the existing plan. Ms. O'Brien asserted that VZ-RI's service quality has been excellent and has improved over time. She explained that the SQP consists of eight statewide service measures and one additional measure reported on an

[2] Id., pp. 5-6.

individual wire center basis covering installation, maintenance and operator services. The points assigned to each individual measure are combined to produce a monthly score. The maximum number of points per month is 42 while the minimum number of points to avoid a penalty is 28 per month. In addition, there is further monitoring in three repair/maintenance areas: Out-of-Service, Not Cleared Within 24 Hours, Missed Repair Appointments and Repair Service Answer Time. If VZ-RI receives 0 points in at least two of these three service categories for consecutive months, VZ-RI incurs a penalty. Also, Ms. O'Brien explained that under the current SQP, an increase occurred in the service quality adjustment factor of 1/12 of 0.5% for each month below 28 points. Ms. O'Brien noted that because the ARP does not include a pricing formula, the new SQP would require a penalty payment of 1/12 of .5% of total annual retail revenue for each month of the year that performance is below 28 points.[4]

In his pre-filed testimony, Mr. Silvia argued that since the passage of the Act, Rhode Island has developed sufficiently competitive market for telecommunications and that price cap regulation is not necessary. He noted that in November 2001, the Commission concluded that VZ-RI had complied with Section 271 of the Act. Mr. Silvia stated that in the VZ-RI central offices that serve 97 percent of VZ-RI's retail lines, all three modes of entry are currently being employed by competitors. Resellers

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[3] Id., pp. 8-9.

are providing service to business and residential customers. Mr. Silvia explained that resale is a quick and attractive option for competitors because of the ease of entry, and the discount level. As for the UNE mode of entry, Mr. Silvia noted that competitive local exchange carriers ("CLECs") have UNE-Platform ("UNE-P") arrangements in every central office and as of February 2002 the use of UNE-P facilities had grown to nearly 4,800 circuits. In the facilities mode of entry, Mr. Silvia noted that CLECs have deployed at least 7 switches and Cox provides telephone services and Internet access through its cable network. Also, he stated that CLECs with facilities had over 106,000 E-911 listings as of February 2002 and that most CLECs service their customer through the facilities based mode of entry.[5]

In addition, Mr. Silvia asserted that the intraLATA toll market has been competitive for many years and VZ-RI estimated that 40 percent of customers currently use a wireline carrier other than VZ-RI for intraLATA toll calling. Also, he stated that wireless carriers were serving over 400,000 subscribers in Rhode Island as of June 2001. As of February 2002, Mr. Silvia stated that competitors were serving almost 135,000 lines an increase of 29,000 lines since May/June 2001, which represents an annual growth rate of 36% in competitor lines while during the same period VZ-RI's total retail access lines decreased by an annual rate of 7%. Mr. Silvia maintained that competitors are serving over 31%

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[4] Id., pp. 10-13.

of the business access lines in the state. Also, he asserted that six years after the passage of the Act, competitors serve nearly 19 percent of the lines in Rhode Island. Consequently, Mr. Silvia argued that price cap regulation should be abandoned in favor of granting more pricing flexibility for VZ-RI.[6]

In his pre-filed testimony, Dr. William E. Taylor commented on the ARP from an economist perspective. Dr. Taylor argued that since the passage of the Act, Rhode Island has become competitive. Therefore, he asserted that all regulatory constraints must be competitively neutral and VZ-RI should have pricing flexibility. Under the ARP, VZ-RI would still be constrained from raising prices on basic residential telephone service and if VZ-RI raised prices on other retail services, it would result in increased competition.[7]

In general, Dr. Taylor discussed the emergence of competition since the passage of the Act. He noted that competitors are providing packaged services of fixed and mobile services associated with voice, data and video thereby reducing the advantage of incumbency in all markets. In particular, Dr. Taylor emphasized the presence of facilities based competition, widely considered the most potent form of competition, in local telephone service and in particular discussed the emergence of Cox,

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[5] VZ-RI Ex. 3 (Silvia's direct testimony), pp. 2-7.
[6] Id., pp. 7-11.
[7] VZ-RI Ex. 4 (Taylor's direct testimony), pp. 3-4.

the cable provider, and wireless competitors in the local telecommunications market.[8]

Dr. Taylor explained that effective competition means a sufficient level of competition to prevent an individual from profitably holding the market price above the competitive price. A firm can exercise market power if it can profitably hold the market price above the competitive level. Dr. Taylor argued that a formal market power study is unnecessary, impractical and could not be completed in a timely manner. Instead, Dr. Taylor utilized standard economic theory which demonstrates the interdependence of market share, supply and demand elasticities to determine market power. Dr. Taylor noted that the supply elasticity can be measured by the extent there are barriers to entry and expansion. Also, Dr. Taylor argued that market share alone can be misleading. Dr. Taylor noted that there are no substantial barriers to entry or expansion and there is competition for business and residential services.[9]

In addition, Dr. Taylor argued that the incumbent and competitors should have symmetric regulation and that competition should function as the price control mechanism. Dr. Taylor argued that pricing flexibility for VZ-RI is necessary for competition because the incumbent should be able to respond to competitors, who focus on high margin customers. According to Dr. Taylor, VZ-RI's ARP will protect residential ratepayers

[8] Id., pp. 4-9.

with a $2 per month per year cap. He argued that if VZ-RI raised prices, either customers would switch to an existing competitor or a new competitor would enter the market and the customer could switch from VZ-RI. Dr. Taylor stated that the lack of actual competitors is irrelevant because if prices increase a new competitor can easily enter the market with little sunk costs because of the availability of resale and UNEs. Also, Dr. Taylor maintained that competition will likely produce lower prices than the current price cap formula.[10]

III. CLEC's DIRECT TESTIMONY

Cox Communications ("Cox") and Conversent Communications ("Conversent"), two CLECs submitted pre-filed testimony on September 20, 2002.[11] Cox submitted pre-filed testimony by Cindy Z. Schonhaut, an outside consultant. In her testimony, she stated that giving VZ-RI unlimited downward pricing flexibility could result in predatory pricing, which occurs when a firm has market power such that it can decrease prices below actual costs so as to cause competitors to exit the market and prevent new competitors from entering the market. Ms. Schonhaut defined actual costs as UNE prices produced by the total elemental long run incremental cost ("TELRIC") methodology. In addition, she argued that pricing below TELRIC would result in a price squeeze for CLECs utilizing UNEs. Ms. Schonhaut conceded that resale would survive

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[9] Id., pp. 9-12.
[10] Id., pp. 12-22.
[11] There were no objections to Cox and Conversent's motions to intervene.

predatory pricing, but the other modes of entry envisioned by the Act would be eliminated.[12] In addition, Ms. Schonhaut suggested that the Commission request that interested parties submit proposals for the appropriate imputation standard and enforcement mechanism for a price floor. Also, she requested that the Commission maintain current pricing regulations for intrastate access services because VZ-RI could manipulate the pricing of different elements within intrastate access service offerings to the detriment of competitors.[13]

Ms. Schonhaut noted that due to the instability and uncertainty in the telecommunications industry VZ-RI should continue under the PRSP until the industry stabilizes.[14] In the alternative, she recommended a three year initial period within which VZ-RI's pricing flexibility for residential customers would remain limited, and for one year, continue the current price regulation for business services. Ms. Schonhaut elaborated by stating that residential rates could be increased by $2.00 per month per year for the first three years after which, these rates would be subject to both a ceiling, and a floor that is TELRIC based. In regards to business rates, Ms. Schonhaut stated that in the first year these rates would remain under price regulation but afterwards would be subject to a ceiling and floor.[15] Also, Ms. Schonhaut recommended that

[12] Cox Ex. 1 (Schonhaut's direct testimony), pp. 15-16.
[13] Id., pp. 17-19.
[14] Id., pp. 19-28.
[15] Id., pp. 28-33.

the issue of funding Internet access for Rhode Island schools and libraries be referred to another proceeding.[16]

Conversent submitted pre-filed testimony by Dr. August H. Ankum. In his testimony, Dr. Ankum stated that in the section 271 proceeding, the issue was whether VZ-RI had complied with the Act by irreversibly opening its local market to competition, but in this proceeding, the issue is whether the level of competition is sufficient to curtail VZ-RI's market power. In addition, Dr. Ankum noted that in order to defeat competition, VZ-RI could increase retail rates to earn high profits at the expense of ratepayers not subject to competition, while at the same time, decreasing retail rates below a price floor in services and regions where VZ-RI faces competition.[17] Dr. Ankum argued that VZ-RI's proposal to establish price caps on certain residential services is an acknowledgment that there is not sufficient competition for such services. Also, he stated that in Rhode Island, UNE-P is not economically viable and VZ-RI is not relieving this problem but is instead proposing to increase UNE rates. Furthermore, he questioned VZ-RI's E-911 data in determining CLEC market share because the E-911 data is proprietary and cannot be validated by intervenors. In addition, he stated that VZ-RI's ARP would allow VZ-RI to price business services on a per customer and per location basis so as to target and harm CLECs.[18]

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[16] Id., pp. 33-34.
[17] Conversent Ex. 3 (Ankum's direct testimony), pp. 9-10.
[18] Id., pp. 11-14.

Dr. Ankum stated that the most vulnerable CLECs are carriers, like Conversent, that use UNEs. If VZ-RI were to lower its retail prices below the UNE rates it charged to CLECs, these CLECs could no longer compete profitably. According to Dr. Ankum, this strategy is known as a "price squeeze." A price squeeze occurs when a vertically integrated firm such as VZ-RI competes against companies such as CLECs in retail markets, while at the same time, controlling prices in wholesale markets for critical inputs, such as UNEs, that its competitors depend upon.[19]

Dr. Ankum emphasized that if VZ-RI has unlimited downward retail pricing flexibility it could selectively target CLEC customers because VZ-RI knows the general location and nature of the CLECs' customers. A CLEC could not match VZ-RI in short-run marginal cost pricing because VZ-RI has a larger rate base and network. According to Dr. Ankum, CLECs would retreat from wire centers, lose their sunk costs in collocation spaces and be deterred from committing to new investments in Rhode Island. Also, Dr. Ankum noted that short run marginal pricing will only decrease prices temporarily because VZ-RI would raise prices once the CLEC competition ceases to exist.[20]

Next, Dr. Ankum discussed the modifications made to VZ's ARP in New York. He cited the requirement of a price floor equal to VZ's incremental costs and an imputation test, the creation of task forces on various issues important to CLECs, a $35 non-recurring charge for a

[19] Id., pp. 14-17.

UNE hot cut, and an agreement from VZ not to challenge the New York Public Service Commission ("NYPSC") UNE rate decision.[21] Dr. Ankum made the following recommended modifications to VZ-RI's ARP: a prohibition on discrimination among similarly situated retail customers so as to prevent VZ-RI from targeting just CLEC customers; a $35 non-recurring charge for a hot cut; a commitment from VZ-RI to continue to offer the set of UNEs it is currently offering; a commitment from VZ-RI to introduce in Rhode Island the outcome of the NYPSC task force regarding competition; and a price floor imputing the TELRIC prices of all UNEs used to provide the service and a proxy for retail costs based on the approved percentage for the resale discount. In addition, Dr. Ankum argued that VZ-RI's request for pricing flexibility is premature because the TELRIC proceeding is not completed. Therefore VZ-RI should commit to the rebuttable presumption that updated UNE prices will be lower and that the terms and conditions for UNEs and interconnection services in New York are presumptively just and reasonable in Rhode Island.[22]

Furthermore, Dr. Ankum discussed the 88% decline in market capitalization for CLECs and interexchange carriers ("IXCs") from 1999 to 2002 as compared to the 44% decline for VZ. Dr. Ankum concluded that

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[20] Id., pp. 17-22.
[21] Id., pp. 20-27.
[22] Id., pp. 28-32.

in light of the vulnerability of the CLEC industry, his proposed modifications to VZ-RI's ARP should be adopted.[23]

IV. DIVISION DIRECT TESTIMONY

On September 25, 2002, the Division of Public Utilities and Carriers ("Division") submitted pre-filed testimony by Thomas Weiss, an outside consultant, and James Lanni, the Associate Administrator for Operations and Consumer Affairs. In his testimony, Mr. Weiss stated that the general form of VZ-RI's APR is appropriate because of the level of competition, especially for business services, in Rhode Island. He agreed with various provisions of the ARP.[24] However, Mr. Weiss stated that the ARP should be effective for a three-year period so as to better assess the effects of the ARP on ratepayers and CLECs. Also, Mr. Weiss opposed VZ-RI's proposal to increase primary basic residential service by $2.00 per month for two years because it could mean an increase in the range of 11.6 percent to 16.2 percent per primary line. According to Mr. Weiss, such a large increase would hinder the objective of "universal basic residential access" in Rhode Island. According to the Division, this obligation remains with VZ-RI "since competition for residential end-user access has yet to develop adequately". In the alternative, Mr. Weiss recommended that only a 50 cent per month per year increase should be allowed for primary basic residential service and a 25 cent per month per

[23] Id., pp. 33-38.
[24] Division Ex. 1 (Weiss' direct testimony), pp. 5-10.

year increase should be allowed for measured rate primary basic residential service.[25]

In addition, Mr. Weiss concurred with VZ-RI regarding its ability to have total pricing flexibility for secondary residential lines and to grant VZ-RI the ability to alter intrastate access rates as long as the effect to intrastate access revenue is neutral. Also, Mr. Weiss supported the adoption of a price floor based on VZ-RI's long run incremental cost ("LRIC") to prevent anti-competitive pricing. According to Mr. Weiss, VZ-RI must either "directly apprise the Commission of its LRIC" or "certify" that is proposed prices are not below LRIC. In addition, he stated that CLECs "should have the right of petitioning the Commission" if the price produces an anti-competitive result and VZ-RI would "have the burden to prove that the proposed prices exceed the appropriate LRIC". As for ancillary services, Mr. Weiss indicated that the Commission should adopt pricing policies that will advance competition while at the same time protecting the universal availability of telephone service to residential customers. He noted that most ancillary services are consumed at the customer's sole discretion but for some services VZ-RI "maintains significant market control". Consequently, Mr. Weiss recommended a ceiling on price increases of fifteen percent annually for these ancillary services.[26]

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[25] Id., pp. 10-12.
[26] Id., pp. 12-15.

In the area of exogenous events, Mr. Weiss noted that under price cap regulation, VZ-RI has only claimed two exogenous events: reductions relating to the state gross receipts tax and a reduction in intrastate costs due to a change in the FCC's jurisdictional cost allocation procedures. Mr. Weiss argued that granting VZ-RI increased pricing flexibility reduces the need for VZ-RI to receive protection from exogenous events. Consequently, Mr. Weiss recommended that the existing $2.5 million annual cap on revenue increases for exogenous events be maintained but VZ-RI be required to absorb the first $2.0 million. As for funding for internet access by schools and libraries, Mr. Weiss noted that VZ-RI is still the dominant carrier, especially for services with "inelastic demand relative to price," such as residential services. He argued that funding for internet access should continue through December 31, 2005 as part of the approval of any ARP. Lastly, Mr. Weiss stated service quality standards must be a component of the ARP.[27]

In his pre-filed testimony, Mr. Lanni described VZ-RI's current SQP which consists of Service Quality Standards, a Service Quality Index ("SQI") and a Customer Survey. In monthly reports, VZ-RI indicates statewide service performance in installations, maintenance, operator services and customer troubles per 100 lines that are reported on an individual wire center basis. Each standard consists of two quality performance levels: Surveillance and Action. Also, Mr. Lanni explained

[27] Id., pp. 15-21.

that the monthly SQI consists of a point system that has 8 statewide service items and 10 Customer Trouble Reports per 100 lines from groups of ten alternating wire centers. In addition, Mr. Lanni discussed that each month, each of these 18 items are compared to the Surveillance and Action levels, and if the performance level is better than the Surveillance Level, it is assigned full credit, which is either 2 or 4 points. If the performance level is between Surveillance and Action levels, it is assigned a partial credit of 1 or 2 points. If the performance level is below Action level, it is assigned 0 points. For each month, the maximum value of the SQI is 42 and the passing monthly score is 28, and for each of the 12 months VZ-RI fails to achieve a passing score, the Service Quality Adjustment Factor ("SQAF") is increased by .0417 percent. In addition, Mr. Lanni noted that if VZ-RI receives 0 points in at least 2 of the three repair categories (Out-of-Service, Missed Repair Appointments, and Repair Service Answer Time) then the SQAF will be increased by .0417 percent. However, the annual SQAF cannot exceed .5 percent.[28]

Mr. Lanni discussed the Division's proposal to tighten the standards of the SQP. The Division recommended a 10 percent reduction in Surveillance and Action Levels in the Installation, Maintenance and Customer Trouble Report service categories. Also, the Division proposed the elimination of the Customer Survey poll and the

[28] Div. Ex. 3 (Lanni's direct testimony), pp. 2-4.

Maintenance Service item for Special Access. Mr. Lanni noted that the Division did accept VZ-RI's proposal to accept SQP payment obligations consisting of one-twelfth of .5 percent of VZ-RI's total annual retail revenue for each month a failure occurs in the SQP.[29]

V. VZ-RI REBUTTAL TESTIMONY

On October 22, 2002, VZ-RI submitted the rebuttal testimony of Ms. O'Brien, Mr. Silvia and Dr. Taylor. In her rebuttal testimony, Ms. O'Brien disagreed with the Division's recommendation of a three-year limit on ARP. Also, she stated that VZ-RI's proposal for a $2.00 per month per year increase would average a 6.4% per year increase for primary basic residential rates. She argued this was reasonable because basic residential rates have not increased since 1994, even with expanded local calling areas. She asserted that today's basic residential rates are similar to these rates in 1985. Furthermore, she stated that a 50-cent cap on basic residential service would be 3.2 percent and would barely keep pace with inflation. In addition, she stated that VZ-RI would increase the Lifeline credit to offset any increase in primary basic residential rates.[30]

As for geographic rate deaveraging, Ms. O'Brien stated that the ARP "neither proposes nor prohibits geographic variations in pricing". Also, she disagreed with a fifteen percent annual cap on other retail services because all these services are competitive to some degree. In

[29] Id., pp. 4-7.

addition, she noted that any change in UNE rates, such as the hot cut non-recurring charge, should be done in Docket No. 2681. Furthermore, Ms. O'Brien reemphasized the CLEC market penetration for business services and noted that Cox has several municipalities and the Providence Place Mall as customers. Ms. O'Brien noted that there is no legal basis to require VZ-RI to fund internet access and to place this burden only on VZ-RI would not be competitively neutral. Lastly, she reiterated that an SQP is unnecessary because market forces are sufficient to maintain service quality.[31]

In his rebuttal testimony, Mr. Silvia disagreed with the Division's recommendation on the treatment of exogenous events. Mr. Silvia stated that during uncertain financial times with state and local budget crises, any restriction on the pass through of exogenous costs would be competitively harmful to VZ-RI. Also, Mr. Silvia argued that the level of UNE-P competition is irrelevant because of the extent of facilities-based competition in Rhode Island. In addition, he noted that the CLECs market share of Rhode Island access lines in service was 13.9 percent in residential, 33.6 percent in business, and 20.9 percent in total for all lines. Lastly, he stated that VZ-RI's E-911 data was found to be a reasonable estimate of competitive entry by facilities-based CLECs.[32]

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[30] VZ-RI Ex. 5 (O'Brien's rebuttal testimony) pp. 1-3.
[31] Id., pp. 3-7.
[32] VZ-RI Ex. 6 (Silvia's rebuttal testimony), pp. 1-7.

In his rebuttal testimony, Dr. Taylor stated that a dominant carrier with a large market share would not have market power if there are no barriers to market entry. Also, Dr. Taylor indicated that successful predatory pricing is not possible because VZ-RI would not be able to permanently force CLECs out of the market. He noted that Cox is a full facilities-based CLEC and is unlikely to exit the market. Also, Dr, Taylor noted that if a UNE-based CLEC exits the market, its facilities will remain in place for other CLECs to use. Also, he stressed that the wholesale resale discount will always allow competitors to "under-price" VZ-RI. Consequently, Dr. Taylor argued that predatory pricing is rarely tried and even more rarely successful. In addition, Dr. Taylor dismissed the possibility that VZ-RI would engage in a price squeeze because as soon as VZ-RI raised its prices to recoup its losses, CLECs would regain customers. Also, he reiterated his argument that the wholesale resale discount option guarantees that a competitor can never be price squeezed because the resale option allows competitors to price below VZ-RI's retail prices and compete profitably.[33]

Regarding the targeting of CLECs' customers, Dr. Taylor argued that VZ-RI already has the pricing flexibility on a per customer and per location basis to compete for contracts with individual business customers. Also, he argued that not allowing geographic deaveraging would continue the misalignment of prices and costs that discourages

[33] VZ-RI Ex. 7 (Taylor's rebuttal testimony), pp. 3-8.

competitors from servicing high cost areas. In addition, Dr. Taylor stated that it is inappropriate for public policy to take account of the needs of any particular CLEC. As for a TELRIC-based price floor for VZ-RI's retail rates, Dr. Taylor noted that Cox has no need for such a price floor and that the existence of the wholesale resale discount option makes such a price floor unnecessary to prevent anti-competitive pricing. Also, he stated that a TELRIC-based price floor would result in higher prices because it would include the recovery of a portion of VZ-RI's shared fixed and common costs. If the Commission were to adopt a price floor, Dr. Taylor recommended that it be set so that VZ-RI's retail price "be above its own marginal cost to provide the service plus any contribution from the UNEs that competitors must purchase from Verizon in order to compete." Furthermore, Dr. Taylor argued that VZ-RI's retail price is lower or slightly above the cost it incurs to provide the basic service, while the price-to-cost margin for vertical services is high.[34]

As for the remaining issues, Dr. Taylor noted that VZ-RI is required to purchase carrier access out of the same tariffs as its competitors and to impute those carriers' access charges in its long distance prices. He stated that VZ-RI should not be the only carrier to provide internet funding because it is not competitively neutral. Also, he disagreed with the Division's recommendation to limit price increases for discretionary services because there is sufficient competition. In addition, Dr. Taylor

[34] Id.,pp. 8-14.

disagreed with the Division's recommendation regarding the treatment of exogenous events, contending that changes in a regulated firm's costs should lead to changes in its prices. As for the current financial health of CLECs, Dr. Taylor argued that CLECs are taking advantage of other CLECs in financial difficulty and that the decrease in capitalization for CLECs has occurred to many other large companies. Lastly, he argued that Rhode Island is the second most competitive state in the nation and that the shakeout among CLECs, including consolidation and acquisitions, will result in robust, viable competition.[35]

VI. CLECS SURREBUTTAL TESTIMONY

On November 7, 2002, Cox submitted the pre-filed surrebuttal testimony of Cindy Z. Schonhaut. In her surrebuttal testimony, Ms. Schonhaut argued that if VZ-RI engaged in predatory pricing, it would only need to recoup enough money to remain profitable on an overall basis instead of being capable of recouping every penny of lost profit. Also, she emphasized the danger of VZ-RI having the ability to engage in selective retail pricing because it could drive out competition in specific geographic or service markets. She stated that CLECs are financially troubled and when new CLECs acquire the assets of failed companies they do not necessarily become active in the market.[36]

Ms. Schonhaut noted there is uncertainty for CLECs because the Commission is also reviewing UNE rates and the FCC is reviewing its

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[35] Id., pp. 14-22.

unbundling policies. In regard to resale, she argued that it is a minor part of the market and as an entry strategy lacks margin and success. In regard to the ubiquity of Cox's network, she stated that Cox still needs to build out its facilities, in particular to business customers. Ms. Schonhaut reiterated that geographically deaveraged rates will result in rural customers paying more for local service than urban customers. She also restated her support of a TELRIC-based price floor for VZ-RI's retail rates. As for internet funding, she recommended that it be addressed in a separate proceeding.[37]

On November 8, 2002, Conversent submitted the surrebuttal testimony of Dr. Ankum. Dr. Ankum disagreed with VZ-RI's assertion that the hot cut rate should be examined in Docket No. 2681 because the cost of UNEs is germane to the ability of CLECs to compete on a retail basis with VZ-RI. He reiterated that pricing flexibility for VZ-RI is premature because the new TELRIC proceeding has not been completed. He also stated that a $35 hot-cut charge is appropriate because VZ would not have agreed to provide hot cuts for $35 (in New York) if the cost to do so was significantly higher.[38]

Dr. Ankum noted that cable companies like Cox, which primarily serve residential customers, may discontinue providing phone service,

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[36] Cox Ex. 2 (Schonhaut's surrebuttal testimony), pp. 2-5.
[37] Id., p. 5-9.
[38] Conversent Ex. 4 (Ankum's surrebuttal testimony), pp. 2-5.

while CLECs that purchase UNEs primarily serve business customers.[39] Dr. Ankum also pointed out that a price squeeze may not affect Cox as it would affect other CLECs that depend upon the purchase of unbundled loops and unbundled interoffice transport from VZ-RI. Also, Dr. Ankum contended that, if VZ-RI has no incentive or ability to carry out a successful anti-competitive pricing strategy, then VZ-RI should concur with the TELRIC price floor that the Massachusetts D.T.E. ordered.[40]

VII. DIVISION'S SURREBUTTAL TESTIMONY

On November 12, 2002, the Division submitted the surrebuttal testimony of its consultant, Mr. Weiss. In his surrebuttal testimony, Mr. Weiss stated that his proposal that the ARP be for a three-year term is no more arbitrary than VZ-RI's proposal that the ARP be for a two-year term. Also, he emphasized that VZ-RI's proposal would eliminate regulation altogether after two years, while the Division's proposal will allow the parties to revisit the issue after two years. He stated that the Division's proposed allowance for a 50 cent increase per month per year for basic residential service is intended to keep pace with historical rates of inflation. Furthermore, Mr. Weiss stated that VZ-RI's $2.00 per month per year proposed increase to basic residential service rates would be equal to a minimum increase of 11.6 percent per line and cause even non-Lifeline service customers to question whether they should continue to take telephone service. Also, Mr. Weiss stated that a 15 percent cap

[39] Id., pp. 5-12.

on price increases applicable to VZ-RI's discretionary services will limit the degree of pricing uncertainty for Rhode Island residential and business customers. Mr. Weiss stated that VZ-RI should continue to fund internet access for schools and libraries in order to promote universal service. Furthermore, Mr. Weiss stated that the Division's proposed exogenous events provisions are necessary to reduce financial uncertainty for VZ-RI and disagreed with Mr. Silvia's recommendations regarding the treatment of exogenous events.[41]

VIII. EVIDENTIARY HEARINGS

After duly published notice, the Commission conducted public evidentiary hearings on the ARP from November 19 through November 22, 2002 at its offices at 89 Jefferson Boulevard in Warwick, Rhode Island. The following appearances were entered:

FOR VZ-RI:	Keefe Clemons, Esq. Alexander Moore, Esq.
FOR DIVISION:	Leo Wold, Esq. Special Assistant Attorney General
FOR ATTORNEY GENERAL:[42]	Paul Roberti, Esq. Assistant Attorney General
FOR CONVERSENT:	Scott Sawyer, Esq.
FOR COX:	Brian Fitzgerald, Esq.
FOR COMMISSION:	Steven Frias, Esq. Executive Counsel

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[40] Id., pp. 12-18.
[41] Div. Ex. 2 (Weiss's surrebuttal testimony), pp. 2-9.
[42] The Attorney General filed a motion to intervene and no objection was filed.

At the November 19, 2002 hearing, members of the Rhode Island educational community gave public comment as to the importance of continuing the funding for internet access for schools and libraries.[43] VZ-RI presented Ms. O'Brien, Mr. Silvia, and Dr. Taylor as a panel of witnesses. Under cross-examination by counsel for the Division, Ms. O'Brien stated that a $2 per month per year increase in basic residential service would result in approximately $7.6 million per year in additional revenues to VZ-RI. She also stated under VZ-RI's proposal it could double the price of residential discretionary services.[44] In response to a question of whether a change in UNE rates would constitute an exogenous event under the ARP, Mr. Silva indicated that there would be no need to recover the costs of providing UNEs other than through UNE rates.[45] Dr. Taylor asserted that full facilities-based competition is the most potent form of competition and acknowledged that, if the local competitive market was limited to just resale or UNE-P competition, the market would be defective. However, Dr. Taylor was reluctant to predict whether a market with only two full facilities-based competitors would be adequate for effective competition to exist.[46] Dr. Taylor acknowledged that this would be a "bad time" to start up a CLEC and that "small CLECs over the course of the next few years may find competing difficult in Rhode Island." Also, Dr. Taylor admitted that the wireline voice

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[43] Tr. 11/19/02, pp. 9-62.
[44] Id., pp. 118-119, 124-125.
[45] Id., pp. 134-137.

market in Rhode Island is stagnant and that VZ-RI can currently bundle products in Rhode Island.[47] Under further cross-examination, Mr. Silvia admitted that the information listed in VZ-RI's competitive profile has not been updated and therefore the CLECs listed in the profile may be bankrupt, no longer providing service, have few customers or may not be providing voice services.[48]

Under cross-examination by counsel for the Attorney General, Ms. O'Brien acknowledged that Cox is VZ-RI's biggest residential competitor and Dr. Taylor admitted that a market dominated by two facilities-based carriers does not necessarily translate into effective competition. Also, Dr. Taylor acknowledged that he had not conducted a Rhode Island-specific analysis to determine the likelihood of CLEC entry to compete against the two existing full facilities-based carriers in Rhode Island.[49]

Under cross-examination by counsel for Cox, Ms. O'Brien concurred that the Division could petition the Commission to reopen the docket if there was "marked change in the competitive landscape", and also indicted that VZ-RI has "no plan to geographically deaverage rates right now". Under the ARP, Ms. O'Brien explained that VZ-RI would file tariff changes and the Commission would approve them in the same manner as it now approves CLEC tariffs.[50] Ms. O'Brien acknowledged

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[46] Id., pp. 147-152, 154-155.
[47] Id., pp. 159, 162, 164, 167.
[48] Id., pp. 147-152, 154-155.
[49] Id., pp. 238. 242, 248.
[50] Id., pp. 256, 258, 260.

that some of VZ-RI's loss of wireline customers could be attributed to their migration to VZ wireless service. Also, Mr. Silva stated VZ-RI could not simply discontinue providing a price-regulated service by means of creating a competitively-priced new service that includes the price regulated service.[51] He agreed that VZ-RI would still be required to offer the price-regulated service as a separate service and could not discontinue it without Commission's approval.

On November 20, 2002, Mr. Weiss was presented as a witness for the Division. Mr. Weiss acknowledged that business customers have benefited the most from local telephone competition. However, with regard to the market for residential plain old telephone service ("POTS"), Mr. Weiss acknowledged the possibility that prices charged by the two main competitors could still increase.[52] Mr. Weiss explained that LRIC differs from TELRIC in that joint costs are not included in LRIC but only the marginal cost plus common cost is calculated. Therefore, Mr. Weiss stated that LRIC will be below TELRIC. Mr. Weiss acknowledged that if VZ-RI could price below the UNE price floor it could force CLECs out of the market. However, he contended, CLECs could reduce their expenses elsewhere to make up the difference.[53] Mr. Weiss admitted that a TELRIC-based price floor would be easier to establish administratively because the Commission could avoid conducting a separate LRIC cost

[51] Id., pp. 268, 277-278.
[52] Tr. 11/20/03, pp. 41, 57.
[53] Id., pp. 66, 78-79.

study proceeding. He also observed that Cox could price below the other CLECs and VZ-RI if a TELRIC price floor was adopted.[54]

Mr. Weiss concurred that the VZ-RI's Section 271 proceedings focused on whether the telephone market was open to competition, and this docket's focus is on whether there is sufficient local competition to restrain VZ-RI from exercising market power. The Division advocated for a middle approach of price ceilings and price floors between the extremes of total price flexibility and rate of return regulation.[55] In this proceeding, Mr. Weiss admitted, he did not examine or determine whether there is sufficient supply elasticity, demand elasticity and CLEC market penetration to restrain VZ-RI from exercising market power. He concurred that supply elasticity means the number of market participants and that, according to a recent FCC report, there are only six CLECs in Rhode Island with more than 10,000 access lines.[56] Also, Mr. Weiss acknowledged the importance of examining the degree of market penetration in determining whether there is sufficient local competition in Rhode Island. He agreed that there is a significant difference in CLEC market penetration between the business and residential markets.[57] He also agreed that there are differences in CLEC market penetration among wire centers. He concurred that VZ-RI's proposal would allow it to deaverage rates and thereby allow VZ-RI to

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[54] Id., pp. 88, 95-96.
[55] Id. pp. 99-100, 118
[56] Id., pp. 103-105.

increase rates in less competitive areas while decreasing rates in more competitive areas.[58]

The cross-examination of VZ-RI's witnesses resumed. Under cross-examination from Conversent, Dr. Taylor acknowledged that the continued availability of UNEs, particularly unbundled loops, at incremental cost could affect competition and could present an economic barrier to entry. Dr. Taylor also noted that in Massachusetts, the two full facilities-based carriers, AT&T Broadband and RCM, serve limited geographic areas unlike Cox, which serves nearly all of Rhode Island.[59]

On November 21, 2002, VZ-RI's witnesses were further cross-examined. Dr. Taylor indicated that in 1995, the FCC granted AT&T pricing flexibility as a non-dominant carrier in all long distance telecommunications, at which time, AT&T had market share in the 70 percent range. For some services, prior to 1995 but after divestiture in 1984, AT&T's services were subject to price ceilings and price floors, and the FCC differentiated between business and residential services as to the degree of pricing flexibility.[60] Dr. Taylor stated that in determining if there is sufficient competition to restrain VZ-RI from exercising market power, the Commission should look at the actual level of competition and if the market is open to competition. He concurred that in making this

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[57] Id., pp. 107-109.
[58] Id., pp. 112-113, 121
[59] Id., pp. 227, 242-243
[60] Tr. 11/21/02, pp. 6-9

determination, market share is one important factor.[61] Dr. Taylor acknowledged that there is “not a small difference” in CLEC market share between the residential and business markets. This difference, along with other factors such as universal service, could be a basis for differentiating pricing flexibility between residential and business customers. Also, he concurred that there is “not a small difference” in the amount of CLEC penetration among wire centers.[62] Ms. O’Brien concurred that wire centers with “not a high number” of CLEC residential market share are areas where Cox has not deployed its facilities and are rural areas. Ms. O’Brien discussed the administrative difficulties of establishing different pricing flexibility standards for categories of wire centers.[63] Dr. Taylor concurred that under VZ-RI’s proposal it could lower its prices in areas with significant CLEC market share while raising its prices in areas with low CLEC market share.[64]

Dr. Taylor asserted that VZ-RI’s proposed price floor and the Division’s price floor is the same. Dr. Taylor agreed it was a possibility that if VZ-RI’s price floor is adopted, a CLEC that utilizes UNEs may have to become a reseller or a full-facilities based carrier in order to compete.[65] Dr. Taylor disagreed with establishing a LRIC price floor for residential services so VZ-RI can compete with Cox, while establishing a

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[61] Id., pp. 14-15, 19
[62] Id., pp. 20-21, 23-25
[63] Id., pp. 27-31, 34-35
[64] Id., pp. 42-43.
[65] Id., pp. 49, 54-55.

TELRIC price floor for business services for which many UNE-based CLECs compete. Also, Dr. Taylor indicated that there is "really no difference" between a LRIC price floor and the anti-trust price floor of average variable cost. Dr. Taylor asserted that if VZ-RI "lowered a price and a competitor or anyone else thought" it was below the LRIC price floor, VZ-RI "would be obliged to present its long run incremental cost".[66] Commissioner Racine expressed concern that under the Division's proposal VZ-RI could raise certain discretionary services as much as 45 percent over three years.[67] Ms. O'Brien indicated that in 2001, VZ-RI had approximately a 4 percent return on equity and in 2002 it had approximately a negative 4 percent return on equity even with the inclusion of directory revenues.[68]

Conversent presented Dr. Ankum as a witness. Dr. Ankum pointed out that resellers are unable to exert pressure on VZ-RI's ability to set prices because the wholesale discount charged to resellers is based on VZ-RI's retail price. Dr. Ankum stated that TELRIC is well-defined in comparison to LRIC, and that CLECs need to pay TELRIC prices to have access to VZ-RI's facilities. Also, Dr. Ankum argued that establishing a TELRIC price floor will incent VZ-RI not to file inflated TELRIC rates.[69] Dr. Ankum expressed concern over giving VZ-RI the pricing flexibility to

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[66] Id., pp. 57-58, 67, 69
[67] Id., pp. 79-81, 93
[68] Id., pp. 112.
[69] Id., pp. 146-147, 153-157.

target a CLEC's particular customers.[70] Dr. Ankum maintained it would be very costly for a CLEC to shift from UNEs to resale but agreed it is less costly to enter the market as a reseller than as a facilities-based CLEC that purchases UNEs.[71] Dr. Ankum acknowledged that New York does not have a TELRIC price floor but UNE-based competition still exists in New York.[72] In regard to Cox, Dr. Ankum argued that Cox's costs are not lower than VZ-RI's and therefore there is no need for VZ-RI to have a LRIC price floor to compete with Cox.[73]

Cox presented Ms. Schonhaut as its witness. Ms. Schonhaut asserted that Cox does not have a ubiquitous network in the business areas of Rhode Island. Although Cox is a full facilities-based CLEC, Ms. Schonahut stated that Cox needs a TELRIC price floor because it needs to purchase UNEs in areas where it lacks facilities.[74]

Cross-examination of VZ-RI's panel of witnesses resumed. Ms. O'Brien acknowledged that VZ-RI is Rhode Island's universal service provider and therefore, the provider of last resort for telephone customers. In addition, she concurred that under state law, the Commission could initiate a proceeding if VZ-RI's prices for residential customers were not just and reasonable.[75] Dr. Taylor asserted that the lack of competition for rural residential customers is due to the lack of

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[70] Id., pp. 170-171.
[71] Id., pp. 178-180, 182.
[72] Id., p. 184.
[73] Id., pp. 218-220.
[74] Id., pp. 268, 286-287.
[75] Id., p. 323.

profit margin and therefore, an increase in rates for these customers would create competition. However, Dr. Taylor maintained that rural residential rates are currently below costs and therefore, competition would cause these rates to rise above current levels.[76]

On November 22, 2002, the Division presented Mr. Lanni as its witness. Mr. Lanni explained that the Division is proposing more stringent service quality standards because over the last six years, VZ-RI service quality has greatly improved. He indicated that the Division's SQP is similar to the SQP in New York but that the Division's SQP has slightly more stringent standards.[77] Under questioning from the bench, Mr. Lanni acknowledged that VZ-RI has done poorly in regards to "Repair Service Answer Time," but has not paid a penalty. However, Mr. Lanni concurred that if Part B of the SQP was revised so that VZ-RI would pay a penalty if, in consecutive months, it failed in one, instead of two out of three service categories, VZ-RI would have consistently failed in one service category last year. As a result, VZ-RI would have paid a $1.375 million service penalty. Mr. Lanni agreed that this type of penalty would incent VZ-RI to improve its service quality.[78] Mr. Lanni conceded that VZ-RI's service quality in the "Out-of-Service, Not Clear Within 24 hours" category has had wide performance variations. Ms. O'Brien noted that poor performance during summer months may result from VZ-RI's

[76] Id., pp. 328-329.
[77] Tr. 11/22/02, pp. 39, 43.
[78] Id., pp. 45-50.

technicians taking vacations.[79] Mr. Lanni noted that VZ-RI is the only telephone carrier in Rhode Island subject to a SQP, and that Cox would likely be the next telephone carrier to be subject to a SQP.[80]

At the close of the hearing, Commissioner Racine noted the importance of maintaining internet access funding for schools and libraries until a more permanent funding mechanism is established.

IX. SETTLEMENT

Following the initial hearings, on December 6, 2002, a Settlement Agreement ("Settlement") entered into between VZ-RI and the Division was filed with the Commission.[81] The terms of the Settlement are the same as the ARP filed by VZ-RI, except for the following provisions. The term of the Settlement is three years ending December 31, 2005. VZ-RI agreed to voluntarily fund internet access for Rhode Island K-12 schools and libraries for two years, until December 31, 2004, in an amount not to exceed $4 million. VZ-RI is allowed to raise primary residential basic exchange rates by no more than $1.00 per month, per year over the initial two years of the ARP; and any increase in such rates for the third year of the Settlement will be subject to Commission approval. VZ-RI will continue to offer all intrastate services provided currently under tariff unless VZ-RI receives Commission permission to withdraw a service, and

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[79] Id., pp. 61-63, 80-81.
[80] Id., pp.90-91.
[81] The Settlement is attached as Appendix A and is hereto incorporated by reference herein. Intervenors Cox and Conversent were not included in the Settlement discussions between VZ-RI and the Division and did not support the Settlement.

VZ-RI will not alter its local calling areas without Commission approval. The retail price floor is LRIC, and upon request of the Division or Commission, VZ-RI will file the necessary documentation to confirm that a price meets the LRIC price floor. If the Commission determines that an exogenous event has occurred, such as a change in tax law, VZ-RI will be allowed to reflect the impact, positive or negative, on its costs or revenues, but VZ-RI will reduce by $1.0 million the cumulative amount to be recovered of any positive changes in its costs or negative changes in its revenues. Generally, VZ-RI cannot recover any exogenous change in excess of $2.5 million during any one year although an excess can be forwarded for recovery in a subsequent period. Various modifications to the SQP proposed by the Division were adopted in the Settlement. Lastly, the parties agreed that approval of the Settlement would not infringe upon the Commission's statutory obligation to protect the public against unreasonable rates in accordance with Title 39 of Rhode Island General Laws.

X. SETTLEMENT HEARING

On December 11, 2002, the Commission conducted a public hearing on the Settlement. VZ-RI and the Division presented Ms. O'Brien, Mr. Silva, Dr. Taylor and Mr. Weiss as a panel of witnesses. In response to concerns expressed by the bench as to how the Division's LRIC price floor would be enforced, Counsel Wold indicated that for the initial price decrease the Division will recommend suspension and investigation of the retail price decrease filed by Verizon. Ms. O'Brien stated that the Commission along with the Division has the right to review future primary residence basic exchange rates.[82] Mr. Weiss indicated that Paragraph 8 of the Settlement gives the Commission "the right to review and where required modify rates to protect the public regardless of what the changes in the prices are". Also, he stated that the Commission could invoke Paragraph 8 "at any time regardless of whether competition went to a negative number." Mr. Weiss concurred that the amount of competition would be one factor for the Commission to look at in determining whether to trigger paragraph 8.[83] Dr. Taylor indicated that his "reading" of Paragraph 8 "is the same as Mr. Weiss" and "that the Commission can do whatever it pleases" and "doesn't need and is not bound by any particular event to trigger an opening of the plan".[84] In response to concerns expressed by Commissioner Gaynor about the possibility of rate discrimination under the ARP, Mr. Weiss testified that it is not "in the public interest for Verizon to treat similarly situated customers differently". Mr. Weiss stated that a higher price floor would be more advantageous for CLECs but not for ratepayers.[85]

Dr. Taylor indicated that wireless telephone—including Verizon wireless service--is providing competition for VZ-RI's wireline telephone service. However, Dr. Taylor noted that the quality of wireless service "is

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[82] Tr. 12/11/02, pp. 42, 45-46.
[83] Id., pp. 47-49.
[84] Id., p. 51.

sometimes, even for digital wireless, quality is bad". Also, "the typical cell phone" does not provide for data transmission. Furthermore, Mr. Silva agreed that there could be dead zones in Rhode Island for obtaining service from wireless carriers.[86] Dr. Taylor acknowledged that in 1993, before the FCC, in regard to AT&T's request for more pricing flexibility, he stated that "the pretense or prospect of competition" was "still insufficiently met in the offer of residential and small business interexchange services and that continued price regulation of AT&T is therefore required." Also, Dr. Taylor indicated that AT&T's residential market share in the early 1990s was approximately 70 percent.[87]

Dr. Taylor admitted that a LRIC price floor will "make it less likely" for a strictly UNE-based CLEC to compete effectively with VZ-RI. Dr. Taylor also acknowledged that "resale by itself doesn't restrict the retail price that Verizon could charge". Ms. O'Brien acknowledged that there are residential and business customers who do not subscribe to Cox as a cable provider. Mr. Weiss acknowledged that if a customer only had resale service as a competitive option, "the ratepayer would have to pay higher rates". Under such a scenario, Mr. Weiss indicated that the Commission would intervene to at least prevent discrimination.[88] Dr.

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[85] Id., pp. 58, 68-69.
[86] Id., pp. 100-103.
[87] Id., pp. 105-107.
[88] Id., pp. 109, 114-119.

Taylor indicated that "irrespective of the plan, the Commission is still obliged by Rhode Island" to enforce the "rules against discrimination".[89]

Ms. O'Brien acknowledged that discretionary residential services could be more expensive for a CLEC to create or purchase from another provider than to purchase from VZ-RI. In comparing the ARP with the PRSP, she agreed that retail services that will not be subject to a price cap under the ARP were either previously contained in Basket 1 under the PRSP, or were retail services previously contained in Basket 2 and subject to a price cap under the PRSP. Counsel Clemons acknowledged that the Commission has the authority to determine VZ-RI's form of regulation.[90] Mr. Weiss construed the LRIC price floor in the Settlement as the equivalent of total service long-run incremental cost ("TSLRIC"). Mr. Weiss conceded that a LRIC price floor could push CLECs that utilize UNEs "out of the market". He stated that a LRIC price floor "is a melding of the costs that are faced by Verizon's competitors". Mr. Weiss indicated that the difference between LRIC and TELRIC is approximately 10 percent.[91]

Counsel Clemons indicated that if a legislative change occurred that made internet funding for schools and libraries a pass-through cost to be recovered from customers, VZ-RI would not consider it to be an exogenous event. Mr. Weiss disagreed, however, indicating that it is the

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[89] Id., p. 120.
[90] Id., pp. 127-133.
[91] Id., pp. 142-143, 151, 172, 182.

"Division's intention to consider" a surcharge for the internet to be a "negative…exogenous change under the terms of this plan."[92] In response to the question of whether the Commission could review a change of law and look at the terms of the Settlement, Counsel Clemons conceded that the Commission has statutory authority to properly regulate utilities. He also indicated that VZ-RI had agreed to extend its internet funding to January 14, 2003.[93] Mr. Silvia acknowledged that VZ-RI would need to demonstrate a sufficient nexus between an exogenous event and price-capped rates in order to obtain Commission approval to pass through an exogenous event increase to price-capped services, but that such approval would not be required to pass through increases to non-capped services. Mr. Silvia agreed to provide the Commission on a periodic basis with the information contained in proprietary Table 1 and Attachment A of his testimony.[94] Ms. O'Brien indicated that the Settlement provides for a 10 percent tightening on four service standards and a 5 percent reduction on one service standard in the SQP.[95]

Mr. Weiss acknowledged that if VZ-RI increased residential rates by a dollar in one area, but did not so in another area, the difference could be construed as discrimination.[96] In response to questioning

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[92] Id., pp. 197, 199.
[93] Id., pp. 198, 200.
[94] Id., pp. 203-204.
[95] Id., p. 209.
[96] Id., p. 229.

regarding Paragraph L, Mr. Silvia indicated that if there was "a huge change in the marketplace," the Commission could "reopen" the Settlement.[97] Mr. Weiss acknowledged that a CLEC could file an objection to a VZ-RI tariff filing on the basis that the VZ-RI price is below the LRIC price floor. Finally, Ms. O'Brien stated that if a VZ-RI price decrease was challenged and then suspended, VZ-RI would provide a "cost filing" and "litigate" within the suspension period.[98]

XI. BRIEFS

A. VZ-RI

On January 7, 2003, VZ-RI filed its brief. At the outset, VZ-RI noted that the Commission has indicated that competition in local telecommunications market is in the public interest and should be implemented as broadly as possible and as soon as possible. VZ-RI reiterated the Commission's finding in the Section 271 proceeding that the local telecommunications market is open to competition and there are no barriers to entry. Also, VZ-RI argued that there is substantial actual competition in Rhode Island because as of August 2002, CLECs were serving approximately 20% of all access lines (approximately 34% of business lines and approximately 14% of residential lines) and, according to the FCC, Rhode Island has the second highest level of CLEC market share in the nation. In addition, VZ-RI noted that there are 450,000

[97] Id., pp. 231-34.
[98] Id., pp. 250-251, 261-262.

wireless subscribers in Rhode Island, but also acknowledged that these wireless services do not completely displace wireline telephones.[99]

VZ-RI argued that the Settlement is in the public interest. VZ-RI noted that it will provide funding for internet access to schools and libraries through December 31, 2004. Also, VZ-RI's ability to increase primary basic residential rates by $1 per month, per year is reasonable since VZ-RI has not increased rates since 1994.[100] VZ-RI argued for a LRIC price floor because it will prevent antitrust violations, and will not result in a price squeeze because a UNE-based CLEC can become reseller or a full facilities-based CLEC. Also, VZ-RI argued that a TELRIC price floor will benefit Cox and will keep retail prices artificially high. VZ-RI also noted that New York has a LRIC price floor.[101] Furthermore, VZ-RI argued that caps on discretionary retail services are unnecessary. VZ-RI stated it should have the ability to geographic deaverage its rates in order to compete on a more level footing with CLECs. Also, VZ-RI noted that under the Settlement, it is required to absorb the first $1 million of increased costs or revenue decreases due to exogenous events, and that the SQP has tightened standards.[102]

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[99] VZ-RI's Brief, pp. 7-14. At an open meeting on January 23, 2003, the Commission held that the total CLEC market share in Rhode Island in Mr. Silvia's Proprietary Table 1 is public. This information is not proprietary because the public has a significant interest in understanding the basis for the Commission granting VZ-RI additional pricing flexibility.
[100] Id., pp. 14-18.
[101] Id., pp. 18-25.
[102] Id., p. 25-31.

B. DIVISION

On January 2, 2003, the Division submitted a letter in lieu of a brief. The Division stated that the Settlement is in the public interest. The Division noted the two-year extension for funding of internet access for schools and libraries and the limitation on increases in primary basic residential rates of a $1 per month, per year for the first two years of the ARP. The Division also pointed out the Settlement's establishment of a LRIC price floor and VZ-RI's concession to reduce its recovery of exogenous event increases by $1 million.[103]

C. ATTORNEY GENERAL

On January 10, 2003, the Attorney General submitted a letter. The Attorney General expressed his support for the Settlement, with certain qualifications. The Attorney General stated that he did not favor the prospect of substantial increases for primary basic residential rates, but viewed VZ-RI's voluntary agreement to extend funding for internet access for schools and libraries as a mitigating factor for the increase. Also, the Attorney General stated that the Settlement should extend internet funding through the third year of the plan. Furthermore, the Attorney General urged the Commission to remain vigilant in monitoring competition to ensure that VZ-RI cannot engage in a price squeeze on CLECs by pricing retail services below LRIC.[104]

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[103] Division's letter 1/2/03.

D. CONVERSENT

On January 7, 2003, Conversent filed its brief. Conversent indicated that a LRIC price floor will allow VZ-RI to engage in a retail price squeeze on CLECs that purchase UNEs. Also, Conversent argued that the Settlement could allow VZ-RI to engage in improper price discrimination.[105] Conversent argued for the adoption of a TELRIC or UNE based price floor, as adjusted with a resale wholesale discount, and for the Commission to follow the example of the Massachusetts D.T.E. in setting a UNE-based price floor for the following reasons: CLECs purchase UNEs at TELRIC prices, to avoid litigation on a LRIC standard, and to incent VZ-RI not to inflate TELRIC prices in its TELRIC cost studies. In particular, Conversent argued that a TELRIC price floor for business services was appropriate because Cox's network does not reach most business areas and cable companies do not offer telephony on a stand-alone basis any more cheaply than the Incumbent Local Exchange Carrier ("ILEC").[106] Conversent noted that in order for VZ to obtain pricing flexibility in New York, VZ agreed to a $35 hot cut non-recurring charge and committed to offer the same set of UNEs as are currently offered for the life of the New York plan.[107]

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[104] A.G.'s letter 1/10/03.
[105] Conversent's Brief, pp. 7-9.
[106] Id., pp. 10-15.

E. COX

On January 7, 2003, Cox filed its brief. At the outset, Cox argued that granting VZ-RI pricing flexibility is premature and that the telecommunications market is unstable. Cox noted that a number of CLECs listed in VZ-RI's competitive profile are bankrupt or no longer providing service. Also, Cox stated its network is not as ubiquitous as VZ-RI's network.[108] Cox argued that resale is unprofitable and cannot put competitive pressure on VZ-RI's retail prices. Also, Cox argued that a LRIC price floor is inadequate for CLECs utilizing UNEs, while a TELRIC price floor with the resale wholesale discount would be administratively easier to enforce. Cox emphasized that a TELRIC price floor would not give Cox an advantage because Cox faces costs not borne by VZ-RI. Furthermore, Cox stated that a TELRIC price floor will incent VZ-RI not to artificially inflate its TELRIC rates. Cox noted that the "only real benefit" of the Settlement is VZ-RI's agreement to provide temporary internet funding for schools and libraries, but Cox maintained that this benefit does not outweigh other policy considerations.[109]

COMMISSION FINDINGS

An obligation of this Commission is to do what is in the best interest of the ratepayers. The enactment of the Act demonstrated that Congress believed that giving ratepayers choice in telecommunications is

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[107] Id., pp. 15-17.
[108] Cox's Brief, pp. 5-15.
[109] Id., pp. 15-25.

in their best interest. This Commission has stated it will not set policies which give a competitive advantage to one carrier over another.[110] In addition, this Commission has declared that the presumed goal of the Act is to "lift the heavy hand of government regulation from the telecommunications market."[111] Accordingly, the time has come for this Commission to determine if VZ-RI should have total pricing flexibility for retail rates.

Granting VZ-RI pricing flexibility requires more than a showing that the market is merely open to competition, which is the standard for a successful Section 271 application. There must be a showing that there is sufficient competition to restrain the VZ-RI from exercising market power. Market power is the ability to profitably raise prices above the competitive level for a sustained period of time.[112] In order to determine if a company can exercise market power, market share, supply elasticity, and demand elasticity for the product is examined.[113] Consequently, the product and geographic markets must first be defined.

In defining the product market in which VZ-RI operates, one needs to assess all reasonable substitutes available to ratepayers. To determine if a service is reasonably interchangeable, the alternative product must be compared for purposes of price, use and qualities.[114] In

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[110] Order No. 16032 (issued 12/15/99), p.11.
[111] Id., p. 9.
[112] Ernest Gellhorn & William E. Kovacic, Antitrust Law and Economics in a Nutshell, 4th Ed., (1994), p. 94.
[113] Id., pp. 95-97.
[114] Id., pp. 98-103.

regard to telecommunications wireline service, there are not reasonable substitutes at this time. Local telephone service is the near instantaneous two-way exchange of audible information. Wireless telephone service is not as reliable, universal or affordable as landline telephone service. VZ-RI noted that wireless service has not completely displaced wireline service. Thus, the product market for local telecommunications is limited to wireline telephone service for the purposes of this analysis.

The next level of analysis is defining the geographic market for local telecommunications services.[115] It is inherently limited to the boundaries of this Commission's jurisdiction which is the State of Rhode Island. This Commission could geographically delineate separate smaller markets based on whether the area is urban, suburban or rural. This, however, could create administrative difficulties in implementing any retail pricing flexibility. Therefore, this Commission will construe the State of Rhode Island, as a whole, as one geographic market because VZ-RI's retail prices are primarily uniform statewide. The general uniformity of VZ-RI's retail prices among different regions of the state provides some assurance that the prices in less competitive regions of a state will be affected by the prices in more competitive areas of the state.

This leads to the next level of analysis, which is measurement of supply elasticity, demand elasticity, and VZ-RI's market share. In regard

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[115] Id., p. 106.

to demand elasticity, the Division indicated that demand was inelastic for some telecommunications services. Presumably, a reason for defining telephone service as a utility service in Title 39 is because the demand for local telephone service is inelastic.

As for supply elasticity, the quantity and quality of CLECs and/or for resellers in Rhode Island is determinative. VZ-RI's competitive profile for Rhode Island was not persuasive. It listed bankrupt CLECs. It also gave no indication as to the type of services available or number of customers served by the CLECs listed. However, a recent FCC report stated that Rhode Island has 6 CLECs with 10,000 or more access lines, which coincidentally approximates the number of CLEC switches in Rhode Island. In other words, there are presently 6 CLECs offering a competitive alternative to VZ-RI in Rhode Island. With the exception of Cox, whose telephone customers are primarily residential, the vast majority of these CLECs' customers are in the business sector.

Furthermore, resellers cannot place competitive pressure on VZ-RI's retail prices and UNE-P CLECs may be phased out of the competitive market. As a result, in assessing supply elasticity for local telephone service in Rhode Island, it appears that full facilities-based CLEC and UNE loop ("UNE-L") CLECs will provide the most effective competition for VZ-RI. In the business market, the evidence indicates that VZ-RI is competing with a number of full or partially-facilities-based CLECs which have acquired slightly more than one-third of *business* access lines in

Rhode Island. However, in the residential market, VZ-RI is primarily competing with only one CLEC, Cox. Consequently, CLECs have acquired less than fifteen percent of residential access lines in Rhode Island. As the evidence demonstrates, the more the supply elasticity for local telephone service, the greater the CLECs' market share. Thus, market share is an adequate indicator of actual supply elasticity.

Market share is the chief tool for assessing the competitive nature of a market.[116] Ordinarily, market power may be inferred from the market share held by the largest company.[117] In antitrust cases, a market share of one company exceeding 70 to 80 percent supports an inference of market power, while courts have routinely held that market shares of one company below 40 percent fail to support a finding of market power. When market share of a company is between 40 percent and 70 percent, courts tend to find market power is lacking, although exceptions do exist.[118]

In Rhode Island, VZ-RI still has more than 70 percent (79.1 percent) of all local access lines. However, once the access lines are distinguished between residential and business lines, the picture becomes much clearer. VZ-RI still has more than 70 percent (86.1 percent) of all local access residential lines. On the other hand, it has less than 70 percent (66.4 percent) of all local access business lines.

[116] Id., p. 113.
[117] Id., p. 117.
[118] Id., pp. 117-118.

Consequently, we find that the degree of pricing flexibility given to VZ-RI should be differentiated based on whether it is providing retail residential or retail business services.

In the Rhode Island business market, the VZ-RI market share is below 70 percent. As a result, we find there is sufficient competition to eliminate the need for any price ceilings on VZ-RI's retail business services.

Due to the more than 70 percent market share of VZ-RI in the Rhode Island residential market, however, the Commission finds there is a continuing need for price ceilings on VZ-RI's retail residential services. The Settlement appropriately allows no more than an increase of one dollar per month per year to basic residential exchange rates for the first two years, with any increase in such rates for the third year to be determined at a later date, subject to Commission approval. The one dollar per month per year increase for residential ratepayers is reasonable in light of the fact that VZ-RI's basic residential exchange rates for primary lines have not been increased since 1994.

However, the Commission has also modified the Settlement by establishing price ceilings of five, ten and fifteen percent per year on increases in rates for the various residential discretionary services listed on page 3 of Appendix A to the Settlement. The price ceilings were determined by the magnitude of the amount currently charged to residential ratepayers for the discretionary service, so that the more expensive a discretionary service, the smaller the allowable price increase. Specifically, the Commission has determined that for residential discretionary services priced at $5.00 or less per month, the maximum annual rate increase is 15 percent; for services priced at $5.01 to $10.00 per month, the maximum annual rate increase is 10 percent; and for services priced at more than $10 per month, the maximum annual rate increase is 5 percent. These ceilings on price increases for residential discretionary services will limit rate increases for discretionary services to no more than approximately one dollar per month and therefore, mitigate rate shock for the more than 50 percent of VZ-RI's residential customers who subscribe to such services and, would be subject to unlimited increases for such common discretionary services as Call Waiting and Caller I.D.

VZ-RI has emphasized its financial difficulties. The Commission notes, however, that some of its loss of wireline customers may be due to its gains of wireless customers. Furthermore, these retail price ceilings may allow VZ-RI the ability to remain financially strong.

VZ-RI has argued that the lack of any barriers to CLEC entry mitigates the relevance of its Rhode Island market share. Economic theory is persuasive, but actual facts are decisive. The possibility that CLECs may enter the market will give little comfort to ratepayers if their rates increase. Although VZ-RI has complied with Section 271 of the Act and eliminated barriers to entry, there are economic factors that continue to discourage market entry. VZ-RI has acknowledged that, due to the current state of capital markets, now may be a difficult time to start up a CLEC. Also, facilities- based competition (full or UNE-L) requires a significant investment of capital and time. In addition, UNE-P competition may not survive in the long run as a viable mode of entry depending on FCC and court rulings. Lastly, while resale is an economically affordable mode of entry, it may lack profitability and certainly cannot put downward pressure on VZ-RI's retail prices. In other words, the door is open but no one may come to the party. Accordingly, to protect the ratepayers, actual market share is the chief criteria for determining the appropriate level of pricing flexibility for VZ-RI.

Currently, the residential market is primarily serviced by two full facilities- based carriers, VZ-RI and Cox. A duopoly may not necessarily result in a competitive market and therefore, residential ratepayers need additional protection. For some time, there may be a need to regulate basic primary residential telephone service, especially for those customers who only have POTS. These customers may never be seen by CLECs as particularly attractive and lucrative business prospects. VZ-RI will likely remain for the foreseeable future the universal service provider for the foreseeable future. However, as the CLEC market share grows in the residential market, we expect the need for price ceilings to diminish.

The Commission must not only protect the ratepayers, but also the continuing development of local telephone competition in Rhode Island which, in the long run, will benefit the ratepayers as well. Competition in both the business and residential markets is in its infancy stage. Therefore, there is also a need to establish retail price floors to protect the competitive process. As to the appropriate price floor, at the higher end of the spectrum is a price floor based on TELRIC and a proxy for retail costs based on the resale wholesale discount. At the low end of the spectrum is the antitrust law price floor of average variable cost.[119] Uniquely, VZ-RI faces competition from UNE-based CLECs as well as Cox, which is a full facilities-based CLEC that is not dependent on leasing UNEs at TELRIC rates from VZ-RI. Consequently, setting a price floor based on TELRIC and the resale discount would make it difficult for VZ-RI to compete with Cox. On the other hand, an antitrust price floor could be too low for UNE-based CLECs, such as Conversent, to compete with VZ-RI or Cox.

Although the Act provides the opportunity for a competitor to enter the local telephone exchange market through various modes of entry, it does not guarantee that every mode of entry will be a success. At this initial stage of competition, it is necessary to ensure that CLECs utilizing UNEs can compete successfully. Accordingly, as a compromise, the Commission has adopted the LRIC price floor set forth in the Settlement.

[119] Id., pp.137-138.

This LRIC price floor will presumably be below TELRIC, but above an antitrust price floor. The Commission anticipates that a LRIC price floor would be approximately 10 percent less than a TELRIC price floor, as indicated by the Division's witness. This type of price floor allows VZ-RI to better compete with its full facilities-based competitor, Cox, while also affording the CLECs utilizing UNEs at least some ability to compete. A LRIC price floor is competitively neutral because it does not significantly advantage one mode of entry over another. In addition, to ensure that the LRIC is properly computed, the Commission expects to suspend a VZ-RI tariff filing for a retail rate below TELRIC so as to trigger a LRIC cost study proceeding. This is consistent with the Division's statement that it would recommend suspension of VZ-RI's initial rate decrease.

Also, a LRIC price floor will prevent VZ-RI from engaging in predatory pricing, which is pricing below its average marginal cost, and will somewhat mitigate the impact of any price squeeze for CLECs utilizing UNEs. Furthermore, the price squeeze concept appears to be of limited applicability in these circumstances. First, a price squeeze could not be applied by VZ-RI to its full facilities-based competitor, Cox, or to resellers. Second, a price squeeze would be ineffective against a CLEC utilizing UNEs to the extent the CLEC can quickly convert to resale. Third, VZ-RI does not control the rates for UNEs; instead, the rates for UNEs are established by the Commission. We will remain vigilant to ensure that VZ-RI does not engage in a price squeeze on CLECs by pricing retail services below LRIC.

Furthermore, imposing a TELRIC price floor on VZ-RI would not necessarily protect UNE-P or UNE-L CLECs from other competitors. Although Cox advocated for a TELRIC price floor for VZ-RI, Cox would not be required to abide by this price floor.[120] Thus, Cox could under-price the UNE-P or UNE-L CLECs even if the TELRIC price floor was imposed on VZ-RI. Under these circumstances, a TELRIC price floor could prevent customers from enjoying lower prices. Also, we note that even though the New York Public Service Commission did not adopt a TELRIC price floor when it granted pricing flexibility to Verizon in New York, UNE-based CLECs are still effectively competing in New York, and New York remains the most competitive state in the nation. Conversent argued that, because New York's UNE rates are lower than Rhode Island's UNE rates, a TELRIC price floor was unnecessary in New York but still needed in Rhode Island. The Commission notes that, although New York's UNE rates are lower than Rhode Island's UNE rates, the FCC, utilizing the Universal Service Fund ("USF") model, noted that this difference was reasonable.[121]

During the hearings, the issue of geographic deaveraging of retail rates arose. This issue could detrimentally affect both retail ratepayers and the development of local telephone competition in Rhode Island.

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[120] Cox data response dated 12/17/02.

VZ-RI has maintained that the local telecommunications market is competitive statewide. However, there are significant differences between CLEC market share in various VZ-RI wire centers. As a general rule, urban areas have more CLEC market share than in suburban and rural areas. In some wire centers, however, the extent of CLEC market share for residential customers is de minimus. Geographic deaveraging by VZ-RI could exacerbate these differences by allowing VZ-RI to lower prices in competitive areas while raising prices in less competitive areas. In particular, geographic deaveraging could harm residential customers in non-urban areas. The approach advocated by VZ-RI's witness, that retail rates must increase in rural areas in order to attract competitors, is not in the public interest. In promoting the development of competition in the electric energy supply sector, this Commission has emphatically rejected the concept of raising rates to create competition.[122] Competition for the sake of competition has not been adopted in the electric sector and it will not be adopted in telecommunications. The objective is lower rates. Competition is the means to this goal; it is not the goal itself.

Geographic deaveraging is not inherently against the public interest. VZ-RI currently has some rates, such as primary basic residential local exchange rates, that have historically been geographically deaveraged by local calling area based upon the number

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[121] FCC's Approval of VZ-RI's 271 Application, paras. 33-57.

of access lines reached by the customers in that calling area. The Commission is concerned that excessive geographic deaveraging of prices could harm customers in less competitive areas of the state or enable VZ-RI to conduct anti-competitive practices by targeting the customers of a specific CLEC. The Commission will vigorously enforce the anti-discrimination provisions of Title 39 of the Rhode Island General Laws and will continue to be vigilant to any rates that appear to constitute price discrimination. Accordingly, if VZ-RI files tariffs to geographically deaverage retail rates that were uniform statewide or within a particular calling area under the PRSP, VZ-RI must rebut the presumption that the proposed rates do not constitute improper discrimination among similarly situated ratepayers. This presumption may prove particularly difficult to rebut if the proposed geographically deaveraged rates affect residential customers.

The Settlement includes various provisions that require elaboration by the Commission. Paragraphs 5 and 8, and section L all give the Commission the flexibility to re-open the Settlement under appropriate circumstances. In particular, Paragraph 8 expressly states that the Commission retains its statutory authority under Title 39 of Rhode Island General Laws. The Commission's statutory authority is particularly broad. There are numerous scenarios that could cause the Commission to utilize its statutory authority to re-open the Settlement.

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[122] Order No. 16916 (issued 2/15/02), pp. 32-34.

The Commission could re-open the Settlement if it results in unreasonable rates for Rhode Island ratepayers, in significant adverse changes in local competition, or in a significant decrease in VZ-RI's retail service quality. Hopefully, the Commission will not need to exercise its statutory authority to re-open the Settlement.

Also, the Settlement includes an exogenous event provision in Section I. According to Section I, VZ-RI has agreed to absorb the first $1 million of exogenous events impact prior to increasing rates. Over time, we expect the need for an exogenous event provision to diminish as VZ-RI obtains greater pricing flexibility. However, there was a disagreement between VZ-RI and the Division as to whether a legislative change that made funding of internet access for schools and libraries a pass-through surcharge on ratepayers would constitute an exogenous event under the Settlement. If and when there is a legislative change regarding internet access funding, the Commission will determine if such an occurrence constitutes an exogenous event.

The Settlement promotes the public interest because it provides for VZ-RI to voluntarily fund up to $4 million of the cost to provide internet access for schools and libraries through December 31, 2004. The development of competition in the local telephone market has reached the stage where the funding for this educational program should not rest exclusively with VZ-RI. The Commission anticipates that the General Assembly will act to ensure there is continued funding for internet access for schools and libraries. The children of Rhode Island should not be dependent on VZ-RI to continue its voluntary funding of this program. If the General Assembly does not act by the end of the 2003 legislative session, the Commission will initiate a universal service rulemaking proceeding to ensure that funding for internet access will continue.

Also, the Settlement provides for a more stringent SQP. As VZ-RI is afforded pricing flexibility the Commission must ensure that service quality for VZ-RI's ratepayers will not decline, especially for customers with limited alternatives, such as residential ratepayers. We note that VZ-RI's service quality has been steadily improving since the passage of the Act. VZ-RI contends there is no need for a SQP because the competitive market will ensure there is reasonable service quality. However, the Rhode Island local telephone market is neither fully competitive with regard to every customer class nor uniformly competitive among all customer classes. Consequently, an SQP for VZ-RI is a necessary customer safeguard, at least for the near future. The Commission may also consider establishing an SQP for CLECs, as the NYPSC has done.

The Commission is hopeful that a fully functioning competitive market in local telephone service for all customer classes will develop. However, if this does not occur, the Commission will need to evaluate the local telephone market and possibly utilize its statutory authority under Title 39 to intercede. To assist the Commission in obtaining data to properly monitor the market, the Commission has modified the Settlement to require VZ-RI to file the information contained in Attachment A in Mr. Silvia's direct testimony and Proprietary Table 1 in Mr. Silvia's rebuttal testimony on a quarterly basis, with the first report due on or before May 15, 2003 for the first quarter of 2003. This information contains data regarding CLEC market share by mode of entry, wire center, residential and business access lines and total access lines. This information will also give the Commission early warning signals of any dysfunction in the local market. In addition, the Commission has directed the Division to provide it with annual reports on the status of local telephone competition in Rhode Island. Lastly, the Commission indicated it will establish a rulemaking proceeding to require CLECs to file annual reports with the Commission, providing information regarding the number and type of its customers, its mode of entry and revenues.

For the time being, the Commission must remain vigilant in monitoring the impact on the competitive local telephone market of the additional pricing flexibility afforded to VZ-RI hereby. We hope that in time, the need for price ceilings and price floors will diminish as the competitive local telephone market fully develops. The more competitive this market becomes, the less need there is for regulatory oversight so that at some point, this Commission would only "intervene and interfere in the natural workings of the competitive market only cautiously and with great circumspection.[123]

VZ-RI may be disappointed that the Commission has not given it more pricing flexibility, particularly in the residential market. However, in 1993 before the FCC, VZ-RI's witness expressed skepticism with regard to AT&T's request for pricing flexibility for residential customers, even though AT&T's residential market share was only about 70%. In comparison, VZ-RI's residential market share is about 85% at present. Under these circumstances, placing price ceilings on VZ-RI's residential rates seems quite reasonable.

The Commission is moving steadily towards a fully developed competitive market with total pricing flexibility for all carriers. This process must be gradual and evolutionary in nature; otherwise, residential ratepayers and even the competitive process could be harmed by rate shock or anti-competitive pricing. The Commission will not guarantee the success of any carrier in the competitive market, but it will act to preserve the competitive process and to protect ratepayers. Ultimately, the existence of actual, fully functioning competition in the local telephone exchange market must precede the implementation of deregulation for VZ-RI.

At an open meeting on January 10, 2003, the Commission reviewed the evidence and approved the Settlement, with certain

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[123] Order No. 16032, (issued 12/15/99), pp. 9-10.

modifications, as just, reasonable, in the public interest, and in the best interest of the ratepayers.

Accordingly, it is

(17417) ORDERED

1. Verizon-Rhode Island's proposed Alternative Regulation Plan filed on July 1, 2002, is hereby denied and dismissed.

2. The Settlement Agreement filed by Verizon-Rhode Island and the Division of Public Utilities and Carriers on December 6, 2002 is approved with the following modifications:

   a. Residential discretionary services listed on page 3 of Appendix A of the Settlement Agreement will be allowed a maximum annual rate increase of 15 percent if currently priced at $5.00 or less per month; a maximum annual rate increase of 10 percent if currently priced at $5.01 to $10.00 per month; and a maximum annual rate increase of 5 percent if currently priced at $10.01 or more per month.

   b. On a quarterly basis, with the First Quarter Report for 2003 due on or before May 15, 2003, Verizon-Rhode Island will file with the Commission the information contained in Attachment A of Arthur Silvia's direct testimony and the information contained in Proprietary Table 1 of Arthur Silvia's rebuttal testimony filed in this docket.

3. The Division of Public Utilities and Carriers shall provide annual reports to the Commission on the status of competition in the local telephone market in Rhode Island. The first report shall be due on or before January 31, 2004. The Division shall consult with the Commission regarding the type of information to be included in these reports.

4. The Commission will initiate a rulemaking proceeding to require the filing of annual reports by competitive local exchange carriers.

5. Verizon-Rhode Island shall comply with all other terms and conditions imposed by the Settlement Agreement and this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND ON JANUARY 10, 2003 PURSUANT TO OPEN MEETINGS ON JANUARY 10 AND 23, 2003. WRITTEN ORDER ISSUED MARCH 31, 2003.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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Kate F. Racine, Commissioner

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Brenda K. Gaynor, Commissioner

April 11, 2003

D.T.E. 01-31-Phase II

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts

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I. INTRODUCTION AND PROCEDURAL HISTORY

In 1995, the Department of Telecommunications and Energy ("Department") approved a petition by NYNEX (now Verizon New England, Inc. d/b/a Verizon Massachusetts ("Verizon" or "VZ")) to replace traditional rate of return regulation of its retail rates and profits with an alternative form of regulation called a price cap. Petition of New England Telephone and Telegraph Company d/b/a NYNEX for an Alternative Regulation Plan for the Company's Massachusetts Intrastate Telecommunications Services, D.P.U. 94-50 (1995) ("Price Cap Order"). The term of the price cap approved in the Price Cap Order was six years. Therefore, after Verizon made its sixth annual price cap filing, the Department directed Verizon to file a proposal for further Department regulation of Verizon's retail telecommunications services.[1] On April 12, 2001, Verizon filed its proposed Alternative Regulation Plan with the Department. The Department docketed its investigation of Verizon's proposal as D.T.E. 01-31.

After receiving comments on the appropriate scope of the proceeding, the Department bifurcated its investigation, determining that the first phase of the proceeding would investigate whether there was sufficient competition for the services for which Verizon sought pricing flexibility in its proposed Alternative Regulation Plan (i.e., Verizon's retail business

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1 Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' Intrastate Retail Telecommunications Services in the Commonwealth of Massachusetts, D.T.E. 01-31, at 2, Vote and Order to Open Investigation (February 27, 2001). The Department directed Verizon to file a proposal that included, at a minimum, a component for regulating or deregulating retail prices, regulating service quality, and intrastate access charge reform. Id.

services).[2] Following an investigation into the state of competition in Massachusetts, on May 8, 2002, the Department issued its Order in Phase I of this proceeding ("Phase I Order").

A. Phase I Order

In the Phase I Order, the Department employed a three-pronged market power analysis of supply elasticity, market share, and demand elasticity, to find that Verizon had successfully demonstrated the existence of sufficient competition to warrant pricing flexibility for most of Verizon's retail business services. Phase I Order at 91.[3] Therefore, the Department granted Verizon's request for pricing flexibility for those retail business services whose components are available on a wholesale basis as unbundled network elements ("UNEs"). Id. at 92. The Department concluded, however, that unlimited downward pricing flexibility for Verizon's retail business services could enable Verizon to engage in a "price squeeze" with respect to UNE-based competitors. Id. at 90. Consequently, the Department implemented an enhanced price floor for Verizon's retail business services, equal to the density zone-specific UNE rates for the elements that make up the service, plus a mark-up for Verizon's retailing costs as reflected in the wholesale discount. Id. at 91.

With respect to Verizon's basic residential services, which would remain a regulated, dominant carrier offering, the Department offered tentative guidance that prices would be judged to be just and reasonable as long as they were between a range of incremental cost as a

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2 Verizon, D.T.E. 01-31, at 17, Interlocutory Order on Scope (June 21, 2001).

3 Consistent with Department precedent, a finding of sufficient competition for a telecommunications service permits the Department to allow pricing flexibility for that service. See, e.g., AT&T Alternative Regulation, D.P.U. 91-79 (1992); NET– Intellidial, D.P.U. 88-18-A (1988); NET– Centrex, D.P.U. 85-275/276/277 (1985).

floor and stand-alone cost as a ceiling. Id. at 101-102.[4] Wholesale services, such as UNEs, interconnection, and resale, would continue to be regulated as monopoly services, pursuant to the requirements of the Telecommunications Act of 1996.[5] The Department directed Verizon to submit to the Department a plan for regulatory treatment of its retail services consistent with the requirements set forth in the Phase I Order.

On June 5, 2002, Verizon submitted its Phase I Compliance Filing incorporating both the Department's directives regarding Verizon's retail business services and the Department's tentative guidance regarding Verizon's retail residential services. The Department determined that Phase II of D.T.E. 01-31 would consist of an evaluation of Verizon's compliance with the Phase I Order, as well as an investigation into proposals for regulatory treatment of Verizon's retail residential services and Service Quality Plan.[6]

B. Phase II Proceedings

Pursuant to notice duly issued, the Department held four public hearings in Phase II of this proceeding on August 27, August 29, September 3, and September 5, 2002, in Pittsfield, Worcester, Boston, and New Bedford, respectively, in order to provide interested persons an opportunity to comment on Verizon's Phase I Compliance Filing. All of the parties to Phase I

4 In the Phase I Order at 96 and n.60, the Department indicated that it was providing tentative conclusions on Verizon's residential services to guide the parties in future presentation of evidence and proof regarding the issues to be addressed in Phase II.

5 Pub. L. No. 104-104, 110 Stat. 56 (1996), codified at 47 U.S.C. §§ 151 et seq. ("Telecommunications Act" or "Act").

6 Verizon, D.T.E. 01-31-Phase II, Interlocutory Order on Appeal of the Attorney General of Hearing Officer's Ruling on the Procedural Schedule (September 3, 2002).

of this proceeding were deemed to be parties to Phase II, with the addition of XO Massachusetts, Inc. ("XO").[7]

At a procedural conference held on August 22, 2002, after discussion of the various procedural schedules for Phase II proposed by the parties and the Department, the hearing officer established a two-track procedural schedule for Phase II: Track A to evaluate Verizon's compliance with the Department's directives in the Phase I Order regarding Verizon's retail business services (including the parties' filing of comments, reply comments, and discovery); and Track B to investigate the appropriate regulatory framework for Verizon's retail residential services and Verizon's proposed Service Quality Plan (including pre-filed testimony, discovery, evidentiary hearings, and briefs).

The Department received comments on Verizon's compliance with the Phase I Order in June and July 2002 from AT&T, the NEPCC, WorldCom, and the Attorney General. Reply comments were received from Verizon and the NEPCC. Three days of evidentiary hearings in Track B of D.T.E. 01-31-Phase II were held at the Department's offices between October 22 and October 24, 2002. At the hearings, Verizon presented the testimony of Dr. William E.

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7 The following parties have intervened in the Department's D.T.E. 01-31 investigation: AT&T Communications of New England, Inc. ("AT&T"); Network Plus, Inc. ("Network Plus"); Global NAPs, Inc. ("GNAPs"); New England Public Communications Council ("NEPCC"); WorldCom, Inc. ("WorldCom"); New England Cable Television Association ("NECTA"); Sprint Communications Company, L.P. ("Sprint"); Association of Communications Enterprises ("ASCENT"); and Qwest Communications Corporation ("Qwest"). Boston Gas Company d/b/a KeySpan Energy Delivery New England ("KeySpan") was granted limited participant status. The Attorney General of the Commonwealth of Massachusetts ("Attorney General" or "AG") filed a notice of intervention in the proceeding pursuant to G.L. c. 12, § 11E. XO's petition to intervene in the second phase of D.T.E. 01-31 was granted by Hearing Officer Ruling on July 2, 2002.

Taylor, Senior Vice President, National Economic Research Associates, Inc.; Paula L. Brown, Vice President– Regulatory Planning and Policy, Verizon; and John L. Conroy, Vice President– Regulatory, Verizon Massachusetts. The Attorney General sponsored the testimony of Dr. David Gabel, Professor of Economics at Queens College in New York City, and Visiting Scholar in the Massachusetts Institute of Technology Internet and Telecommunications Convergence Consortium. AT&T sponsored the testimony of Dr. John W. Mayo, Professor of Economics, Business, and Public Policy at Georgetown University.

The Phase II (Track B) evidentiary record consists of 117 exhibits. Verizon entered seven exhibits, the Attorney General entered six exhibits, and AT&T entered six exhibits. Verizon also sponsored as individual exhibits 94 Track B information request responses; the Attorney General sponsored as exhibits four information request responses. The record also includes responses by Verizon to one record request by the Attorney General and two supplemental record requests by the Department. Track B briefs were filed by Verizon, the Attorney General, WorldCom, and AT&T. Reply briefs were filed by Verizon, the Attorney General, AT&T, and the NEPCC.[8]

II. STANDARD OF REVIEW AND REGULATORY HISTORY

A. Statutory Requirements

The Department's jurisdiction for regulation of intrastate telecommunications common carriers within the Commonwealth is provided under G.L. c. 159. The Department has broad general supervisory power over the provision of telecommunications services. G.L. c. 159,

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8 The Department also permitted limited discovery as part of our Track A compliance evaluation and we hereby move the Track A information request responses into the record of our Track A evaluation.

§ 12; see also G.L. c. 166. Sections 14 and 20 of G.L. c. 159 give the Department authority over the rates of common carriers subject to the Department's jurisdiction.[9] See also G.L. c. 159, § 17 ("All charges made . . . by any common carrier for any service rendered . . . shall be just and reasonable . . . and every unjust or unreasonable charge is hereby prohibited and declared unlawful").

Thus, under G.L. c. 159, the Department is responsible for enforcing a "just and reasonable" standard for all common carrier rates. Section 14 also requires that rates not be unjustly discriminatory or unduly preferential. See Attorney General v. Department of Pub. Utils., 390 Mass. 208, 234 (1983), citing American Hoechest Corp. v. Department of Pub. Utils., 379 Mass. 408, 411 (1980).

While the General Court specifies that rates are to be "just and reasonable" and that rates should provide a utility with "reasonable compensation" with reference to the service

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[9] G.L. c. 159, § 14 states in part:

> Whenever the department shall be of the opinion, after a hearing had upon its own motion or upon complaint, that any of the rates, fares or charges of any common carrier for any service to be performed within the commonwealth, or the regulations or practices of such common carrier affecting such rates, are unjust, unreasonable, unjustly discriminatory, unduly preferential, in any wise in violation of any provision of law, or insufficient to yield reasonable compensation for the service rendered, the department shall determine the just and reasonable rates, fares and charges to be charged for the service to be performed . . . [emphasis added].

G.L. c. 159, § 20 states in part:

> If [as regards] . . . any proposed decrease in any rate . . . it shall appear to the department that the said rate, joint rate, fare, telephone rental, toll or charge is insufficient to yield reasonable compensation for the service rendered, the department may determine what will be a just and reasonable minimum to be charged . . . [emphasis added].

provided, neither of these two statutes prescribe a particular method by which the Department must fulfill its statutory mandate of ensuring just and reasonable rates or limit the Department to a specific regulatory scheme, such as cost-of-service, rate of return ratemaking, or regulation through a price cap. See NYNEX Price Cap, D.P.U. 94-50, at 37-38, Interlocutory Order on Motion to Dismiss of NECTA (February 2, 1995) (containing a comprehensive evaluation of Department authority to permit alternatives to the rate of return regulation model).

B. IntraLATA Competition Order, D.P.U. 1731 (1985)

In D.P.U. 1731, subsequent to the 1984 divestiture of the Bell Operating Companies from AT&T, the Department developed a new framework of regulation for all common carriers in Massachusetts. IntraLATA Competition Order, D.P.U. 1731 (1985). In that Order, the Department established telecommunications policy goals and adopted an overall regulatory framework and pricing approach flexible enough to react to marketplace changes.[10] Id. The Department determined that while simulation of the results of a competitive market is a principal goal of regulation, actual competitive telecommunications markets are preferable to regulation as a surrogate for competition. Id. at 25. The Department endorsed competitive markets over regulation as the best way to achieve its policy goals for telecommunications, because competitive markets promote economic efficiency, technological innovations, and a greater sensitivity to customer demands. Id.

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10 The three public policy goals adopted by the Department in D.P.U. 1731 were economic efficiency, fairness, and universal service. D.P.U. 1731, at 19-24. The Department later adopted the additional policy goals of simplicity, earnings stability, and continuity. New England Telephone and Telegraph Co., D.P.U. 86-33-C at 22 (1987).

In that Order, the Department created a regulatory classification of carriers as "dominant" or "non-dominant," in order to determine the level of price regulation that would be applied to all common carriers. Id. at 61-62, 67-69. Under this classification, dominant carriers were subject to traditional regulatory requirements, and non-dominant carriers were presumed to be disciplined by market forces and to have no ability to exercise market power. Id. at 64. Dominant carriers were allowed to petition for a change in classification in response to marketplace changes. Id. at 65. While retaining traditional rate of return regulation for New England Telephone and Telegraph ("NET," now Verizon) and for AT&T as dominant carriers, the Department stated, "[I]f an entire service class is determined to be fully competitive by the Department, we may find that the prices set by the market are fair and reasonable, and we will regulate such service class in accordance with the minimum statutory requirements. Such a determination may be made only upon a showing by [the carrier] that such a service is fully competitive." Id. at 39-40. Thus, the Department anticipated that Massachusetts markets could reach a point where competition, rather than regulation, would govern the prices for some of a dominant carrier's retail telecommunications services.

C. New England Telephone and Telegraph Co., D.P.U. 89-300 (1990)

Beginning in 1986, the Department conducted a multi-phase investigation into the costs and rates of NET, including approval of a marginal cost study. New England Telephone and Telegraph Co., D.P.U. 86-33-0 (1990). The Department then began a series of annual, revenue-neutral "rate re-balancings" to bring NET's retail rates more in line with the underlying cost structure. New England Telephone and Telegraph Co., D.P.U. 89-300 (1990); New England Telephone and Telegraph Co., D.P.U. 91-30 (1991); New England

Telephone and Telegraph Co., D.P.U. 92-100 (1992); New England Telephone and Telegraph Co., D.P.U. 93-125 (1994). In that process, the Department significantly reduced the rates for business customers and toll, local usage, and switched access services, as well as eliminated message units and different rate groups for local unlimited services. The Department also increased rates for some basic residential services, including the fixed rate for the dial-tone line and for analog private line services.

D. AT&T Alternative Regulation, D.P.U. 91-79 (1992)

In D.P.U. 91-79, AT&T filed a petition requesting that the Department adopt an alternative form of regulation for AT&T's Massachusetts intrastate services. AT&T proposed that certain of its services be classified as "Category M" (i.e., sufficiently competitive) services, with prices set by competitive market forces, and its remaining services classified as "Category D" services, with prices regulated according to a price cap. AT&T Alternative Regulation, D.P.U. 91-79 (1992). In classifying the majority of AT&T's services as Category M, and thus subjecting those services to reduced regulatory scrutiny, the Department stated that "sufficient market forces are in place to ensure that rates charged by AT&T for its proposed Category M services are just and reasonable." Id. at 34. The Department based its decision on an analysis of market share, supply elasticity, and demand characteristics, and concluded that AT&T did not have market power in Massachusetts with regard to Category M services. Id.

Regarding AT&T's Category D services, the Department found that, although there was not as much competition as with Category M services, there was some competition since Basic (low volume) MTS customers had alternatives to AT&T for long distance service. Id.

at 43. The Department determined that any market power that AT&T had was the result of demand inertia and not bottleneck control of the market. Id. at 44. Thus, the Department found that rate of return regulation would not be necessary. Id. The Department determined that the weighted-average price cap mechanism it approved for AT&T contained sufficient regulatory safeguards which, coupled with market forces, would result in just and reasonable rates for AT&T's Basic MTS customers. Id. at 34. Except for Basic MTS and operator services, prices for AT&T's services were regulated according to market-based pricing principles, in the same way that the Department regulated prices of services offered by non-dominant carriers.

E. Entry Deregulation, D.P.U. 93-98 (1994)

In D.P.U. 93-98 (1994), the Department eliminated the certification requirement for telecommunications providers that seek to do business in Massachusetts, and required instead that carriers register with the Department. The Department found that "current market forces, statutory requirements, and the Department's tariff regulations, notice requirements, and consumer complaint resolution process, are sufficient to ensure not only that rates are just and reasonable but that there is adequate consumer protection for interexchange, competitive access, and [alternative operator services], absent the regulation of entry into these markets." Entry Deregulation, D.P.U. 93-98, at 12 (1994).

F. Price Cap Order, D.P.U. 94-50 (1995)

In D.P.U. 94-50, the Department concluded that adoption of a price cap as an alternative form of regulation for NYNEX (now Verizon), did not require a specified level of competition or market structure; however, "[i]f NYNEX were requesting market-based pricing in the instant petition, it would certainly be required to make a showing of effective competition in order for the Department to consider granting such relief." D.P.U. 94-50, at 112-115 (1995). The Department also concluded that price cap regulation was not appropriate for a fully competitive market and "if effective competition exists, no rate regulation whatsoever (ROR regulation, price caps, etc.) would be needed . . . [because] [i]n a competitive market, competition itself will lead to an efficient outcome." Id. at 113.

III. TRACK A: COMPLIANCE WITH THE PHASE I ORDER

A. Introduction

As noted above, Verizon's Phase I Compliance Filing consists of two separate components: (1) Verizon's compliance with the Department's directives in the Phase I Order regarding regulation of Verizon's retail business services (i.e., the Department's "Track A" compliance evaluation); and (2) Verizon's proposed regulatory treatment of its retail residential services and Service Quality Plan (i.e., the Department's "Track B" evidentiary proceeding). This section contains our Track A evaluation of Verizon's compliance with the Phase I Order directives on retail business services.

B. AT&T's Motion for Summary Judgment

1. Introduction

On December 13, 2002, AT&T filed in Track A of this proceeding, a Motion for Summary Judgment, or, in the Alternative, Motion for Leave to Present Evidence and File Briefs Regarding Verizon's Failure to Comply with the Department's Phase I Order ("AT&T Motion for Summary Judgment"). Pursuant to the schedule established by the hearing officer, responses to AT&T's Motion for Summary Judgment were filed by WorldCom, the Attorney General, and Verizon; AT&T and Verizon filed replies.

2. Standard of Review

The Department's procedural rules authorize the use of full or partial summary judgment in Department decisions. 220 C.M.R. § 1.06(6)(e). The rule specifically provides that "[a] party may move at any time after the submission of an initial filing for dismissal or summary judgment as to all issues or any issue in the case." Id. Summary judgment may be granted by an administrative agency where the pleadings and filings conclusively show that the absence of a hearing could not affect the decision. Massachusetts Outdoor Advertising Council v. Outdoor Advertising Board, 9 Mass. App. Ct. 775, 783-86 (1980); see also Hess & Clark, Div. of Rhodia, Inc. v. Food and Drug Administration, 495 F.2d 975, 985 (D.C. Cir. 1974). The standard of review on motions for summary judgment in judicial proceedings is instructive and satisfies the requirements of procedural due process in administrative proceedings. 9 Mass. App. Ct. at 789; see also Mass. R. Civ. P. 56.

In determining whether to grant a motion for summary judgment, the Department will review the initial pleadings, pre-filed testimony, responses to discovery, and the memoranda of the parties. IMR Telecom, D.P.U. 89-212, at 12 (1990). Summary judgment is appropriate if a review of the materials on file shows that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Cambridge Electric Light Company/MIT, D.P.U. 94-101/95-36 (1995), citing Re Altresco Lynn Inc./Commonwealth Electric Company, D.P.U. 91-142/91-153, at 10 (1991). An opposing party may not rest on mere allegations or pleadings, but must support that opposition by affidavit and supporting papers. See Mass. R. Civ. P. 56(e). If an opposing party demonstrates "an authentic need for, and an entitlement to, an additional interval in which to marshal facts essential to mount an opposition," the Department may deny the motion for summary judgment or order a continuance to permit the opposing party to obtain further discovery. See Resolution Trust Corp. v. North Bridge Assoc., 22 F.3d 1198, 1203 (1st Cir. 1994); Mass. R. Civ. P. 56(f).

3. Positions of the Parties

a. AT&T

In its Motion for Summary Judgment, AT&T argues that summary judgment is warranted on the following two independent grounds: (1) Verizon has failed to show that its retail business services are contestable using UNEs; and (2) Verizon has failed to reduce special access charges to Total Element Long Run Incremental Cost ("TELRIC") (AT&T Motion for Summary Judgment at 5, 32). Because Verizon has failed to present evidence on these two essential elements of the Department's Track A evaluation, AT&T argues that the Department should grant summary judgment in AT&T's favor and dismiss Verizon's Phase I Compliance Filing (id. at 5, 32).

AT&T argues that in the Phase I Order, the Department required Verizon to identify its retail business services that are not contestable on a UNE basis, and Verizon has failed to identify such services (id. at 5). AT&T argues that, in Verizon's Phase I Compliance Filing, Verizon has asserted that all of its business services are contestable using UNEs, but has not provided any factual support for this assertion and has not addressed AT&T's arguments that competitive local exchange carriers ("CLECs") cannot use UNEs to provide competing services in the face of the restrictions that Verizon places on them (id.).[11] AT&T further argues that if the Department believes that there are disputed issues of material fact as to whether CLECs can compete for Verizon's retail business services on a UNE basis, the Department should hold hearings to resolve the disputed facts (id. at 30-31).

AT&T argues that Verizon is incorrect to assume that the Department's Phase I Order included a blanket grant of pricing flexibility for Verizon's retail business services (AT&T Reply at 2). Rather, AT&T argues that the pricing flexibility discussed in the Phase I Order will apply only after Verizon has shown that every business service is contestable on a UNE basis (id.). Moreover, AT&T argues that Verizon's response to AT&T's Motion for Summary Judgment contains bald assertions only, and fails to address, let alone explain, how Verizon has met its burden to demonstrate contestability (id. at 5).

In addition, AT&T argues that Verizon has failed to reduce special access charges to TELRIC as required by the Phase I Order, and, therefore, AT&T argues that the Department should grant summary judgment in AT&T's favor and dismiss Verizon's Phase I Compliance Filing on this separate ground (AT&T Motion for Summary Judgment at 33-34). Finally, AT&T argues that, whether or not the Department grants AT&T's Motion for Summary Judgment, the Department could expedite its long-term goal of using markets to discipline Verizon's pricing power by addressing the restrictions Verizon imposes on CLECs' use of

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11 In its Motion for Summary Judgment, AT&T provides a comprehensive discussion of Verizon's restrictions on CLECs' use of enhanced extended links ("EELs"), the prohibition against commingling of CLECs' UNE and access traffic, Verizon's "no facilities, no build" policy, and the lack of cost-effective mass migration from UNE-Platform ("UNE-P") to UNE-Loop ("UNE-L") (AT&T Motion for Summary Judgment at 7-30).

UNEs (id. at 34). AT&T argues that such discipline could include, for example, the Department's establishing a set of "safe harbors"[12] that are different from those established by the FCC (id. at 35-42).

b. WorldCom

WorldCom supports AT&T's Motion for Summary Judgment in all respects (WorldCom Response at 1).

c. Attorney General

The Attorney General argues that the record in the Track A compliance evaluation is not sufficient for the Department to make a finding as to whether Verizon has complied with the Department's directives in the Phase I Order (AG Response at 2). Specifically, the Attorney General argues that the record on the contestability of Verizon's business services is incomplete because Verizon has produced some, but not a complete, factual response to AT&T's charges of non-contestability (id. at 6).[13] The Attorney General further argues that the parties were unable to subject Verizon's limited response to cross-examination or briefing under the Track A procedural schedule as set in the August 22, 2002 procedural conference (id.). The Attorney General argues that summary judgment is therefore inappropriate, and that further hearings are necessary (id. at 6-7). The Attorney General argues that Verizon

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12 "Safe harbors" are the standards set by the FCC that CLECs must meet in order to avoid UNE use restrictions. See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, Supplemental Order Clarification, FCC 00-183, at ¶ 22 (rel. June 2, 2000) ("Supplemental Order Clarification").

13 The Attorney General asserts that the Track A record on contestability consists only of Exh. DTE-ATT 1-1 and Verizon's October 15, 2002 Supplemental Response (AG Response at 6).

must present a full factual case (including additional discovery, testimony, cross-examination, and briefs) regarding the contestability of Verizon's business services (id. at 8). The Attorney General suggests that the Department should examine issues regarding contestability as part of an examination of residential price squeeze and universal service issues in the next phase of this proceeding (id.).

d. Verizon

Verizon argues that AT&T's Motion for Summary Judgment should be denied as an abuse of process (VZ Response at 1, 4). Verizon argues that AT&T has repeatedly introduced the issues of UNE use restrictions and commingling prohibitions, and that the Department has rejected those arguments each time (id. at 2-6). Verizon further argues that AT&T's request for additional hearings if the Department denies AT&T's Motion for Summary Judgment should be rejected (id. at 6). Verizon argues that AT&T did not appeal the procedural schedule established at the outset of Phase II, and, thus, AT&T has waived any objection to the process established to evaluate Verizon's compliance with the Phase I Order (id. at 7).

In addition, Verizon argues that it has rebutted every argument raised by AT&T in Phase II regarding the ability of CLECs to compete using UNEs (id.). Verizon argues that it has provided detailed discussions on its "no facilities, no build" policy, as well as its alleged UNE provisioning problems (id. at 8-9). Verizon further argues that the Attorney General's proposal to hold additional hearings on contestability renders the Department's conclusions on the sufficiency of competition for Verizon's business services in the Phase I Order meaningless, and, thus, the Attorney General's proposal should also be rejected (VZ Reply at 2). Lastly, Verizon argues that although the Department did not require that Verizon reduce intrastate special access charges in the Phase I Order, the parties have already discussed this issue at length in the Track A record, and no further record is required in order for the Department to determine the matter (VZ Response at 9).

4. Analysis and Findings

For the following reasons, we dismiss AT&T's Motion for Summary Judgment. The Track A procedural schedule (established to evaluate Verizon's compliance with the Phase I Order) did not include evidentiary hearings on the issue of compliance.[14] Instead, we determined that Verizon's compliance with the Department's requirements set forth in the Phase I Order – as demonstrated by Verizon's June 5, 2002 Phase I Compliance Filing – could be adequately evaluated through the written comments filed by the parties, followed by a short period of discovery.[15] No party appealed the Track A procedural schedule established by the hearing officer at the August 22, 2002 procedural conference.[16]

Summary judgment is customarily used as a device to obviate the need for evidentiary hearings, as evidenced by Department Orders issued in the past addressing partial and full summary judgment. See, e.g., AT&T/National Interactive Systems/CommNetics, Inc.,

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14 See Transcript of Procedural Conference, D.T.E. 01-31-Phase II at 23-24 (August 22, 2002); Hearing Officer Email to Parties Attaching Procedural Schedule, D.T.E. 01-31-Phase II (August 22, 2002).

15 Written comments on Verizon's compliance filing were due June 25, 2002, and reply comments were due July 16, 2002. AT&T, WorldCom, NEPCC, and the Attorney General filed written comments; Verizon and NEPCC filed reply comments. The open discovery period for Track A ran from August 22, 2002, to September 20, 2002.

16 The Department addressed the Attorney General's appeal of the Track B procedural schedule in Verizon, D.T.E. 01-31-Phase II, Interlocutory Order on Appeal by the Attorney General of Hearing Officer's Ruling on the Procedural Schedule (September 3, 2002). At that time we emphasized that "[t]he Track A procedural schedule remains as established in the August 22, 2002 procedural conference." Id. at 2 n.2.

D.P.U. 91-140, at 25 (1991); Altresco Lynn, Inc./Commonwealth Electric Company and Cambridge Electric Company, D.P.U. 91-142/91-153, at 15 (1991). By determining that evidentiary hearings were not required in Track A, the Department was, in effect, reaching the same conclusion that results from granting a motion for summary judgment; that is, that the absence of a hearing will not affect the Department's decision, and that our decision may be made on the basis of pleadings, material obtained from discovery, and other filings. See 9 Mass. App. Ct. at 785-86; see also Mass. R. Civ. P. 56.

In addition, in the instant proceeding, the Track A discovery period has been long-closed, and it is unclear what procedure AT&T seeks to dispose of by moving for summary judgment at this time. See Price Cap Order at 33-37 (discussing post-hearing motion for summary judgment filed for the purpose of disposing of the need for parties to review and brief certain issues). Nevertheless, our procedural rules allow parties to move for full or partial summary judgment "at any time" after the submission of an initial filing;[17] therefore, we do not agree with Verizon that AT&T's submission of a motion for summary judgment at this stage of the proceeding is per se an abuse of process. But we determine that AT&T's arguments regarding Verizon's lack of compliance as set forth in AT&T's Motion for Summary Judgment concerning special access pricing and contestability of business services, were also included in AT&T's written comments on Verizon's compliance filing and AT&T's responses to discovery (which are part of the Track A record and which we discuss at length in Sections III.C, and III.D, below). We determine, therefore, that ruling on AT&T's motion is unnecessary because the motion argues in favor of the procedural approach we have already

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[17] 220 C.M.R. § 1.06(6)(e).

established and includes arguments already provided and responded to in the Track A record. Moreover, no party is harmed by our declination to address AT&T's arguments in a ruling on a motion we deem to be procedurally redundant and unnecessary, and, thus, we dismiss the motion.

In response to AT&T's alternative Motion for Leave to Present Evidence and File Briefs Regarding Verizon's Failure to Comply with the Department's Phase I Order, we determine that this motion, in substance, constitutes an untimely appeal of the hearing officer's ruling establishing the Track A procedural schedule, and that AT&T has not shown good cause for such an extended delay in filing its appeal.[18] Therefore, we also dismiss this portion of AT&T's motion.[19]

In sum, because we have already determined that evidentiary hearings are not required as part of our Track A compliance evaluation, it is not necessary to rule on AT&T's motion seeking to obtain a judgment on the filings, and, thus, we dismiss the motion. However, we fully address the arguments raised by AT&T in its written comments and responses to discovery regarding Verizon's compliance with our directives in the Phase I Order

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18 As noted above, the Track A procedural schedule was established on August 22, 2002, and AT&T's Motion for Leave to Present Evidence and File Briefs was filed on December 13, 2002 – nearly four months later.

19 We also conclude that the Attorney General has misconstrued the Department's Phase I determinations. Our evaluation of the sufficiency of competition for Verizon's retail business services was completed in Phase I with the issuance of the Phase I Order. We affirmed our conclusions on the sufficiency of competition in Verizon, D.T.E. 01-31-Phase I-A at 2-9, 14, Order on Attorney General's Motions for Reconsideration and Extension of Judicial Appeal Period, and AT&T's Motion for Clarification (August 5, 2002). Therefore, we do not agree that it is warranted to undertake an additional investigation into competition for Verizon's retail business services as part of a third phase of this proceeding.

(specifically, our requirements concerning special access pricing and identifying business services that are not contestable using UNEs) in the following sections.

C. Special Access Pricing

1. Introduction

In our Phase I investigation, we found that CLEC supply elasticity is lower for private line services,[20] compared to other Verizon retail business services, such that "CLECs could not be expected to have the same controlling effect on prices for these services." Phase I Order at 58. In Phase I, we agreed with the CLECs' argument that current special access pricing constitutes a barrier to entry because it levies higher costs on CLECs than those levied on Verizon. Id. at 61. Therefore, the Department determined that Verizon would be granted upward pricing flexibility with regard to private line services only after special access services are moved to UNE-based pricing. Id. at 91.

2. Positions of the Parties

a. Verizon

Verizon argues that the Phase I Order offers Verizon the choice of whether to reduce intrastate special access rates to UNE levels and obtain pricing flexibility, or alternatively, to maintain current intrastate special access rates and have private line services remain subject to price regulation (Phase I Compliance Filing at 3). Verizon asserts that "the Department stated that Verizon MA could obtain pricing flexibility if it chose to reduce Intrastate Special Access rates to UNE levels" because the Department concluded that other carriers were unable to

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[20] Verizon's analog and digital private line services are the retail equivalent to wholesale special access service. Phase I Order at 61. Special access is a dedicated line from an end-user to a long distance company. Id. at viii n.2.

provide competing private line services through UNEs and had to use special access services in order to do so (id.). Notwithstanding the Department's conclusion, Verizon argues that private line services "are competitive today and can be provided via UNEs" (id.). Verizon also argues that Tab C of its Phase I Compliance Filing identifies Verizon private line offerings and lists the UNEs that can be used by carriers to provide competing services (id.).

Moreover, Verizon argues that lowering intrastate special access rates to UNE levels raises a significant potential for arbitrage between state and Federal special access services (id.). Verizon asserts that the FCC does not permit carriers to purchase interstate special access at UNE rates, and that a decrease in intrastate special access rates presents an opportunity for "tariff shopping," which would conflict with Federal policies and seriously erode Verizon's interstate revenues (id.).

For these reasons, Verizon states that it is opting not to obtain pricing flexibility for private line services, but chooses instead to continue to have these services subject to price regulation (id. at 4). Verizon proposes that its Alternative Regulation Plan limit overall increases in price for private line services to 15 percent per annum (id.). In addition, Verizon argues that it should be permitted to raise, lower, or restructure prices for private line services as long as they do not exceed the 15 percent annual limit and continue to remain above the relevant price floor as determined by the Department (id.).

b. CLECs

AT&T asserts that the Department required Verizon to price intrastate special access at UNE rates because Verizon's current prices are a barrier to entry, leading to Verizon retail prices above economically efficient levels (AT&T Comments at 2). AT&T argues that

Verizon has misinterpreted the Department's Phase I Order to conclude that the Department did not really require Verizon to price its intrastate access circuits at UNE levels (id. at 3). AT&T also argues that the Department never stated that Verizon had the right to choose whether to reduce its intrastate special access rates or not, nor did the Department indicate that Verizon could obtain pricing flexibility if it exercised such a right to choose (id.). Therefore, AT&T argues that the Department should "reject Verizon's self-serving interpretation of the Phase I Order" and require Verizon to comply with the Department's intrastate special access pricing requirements (id. at 4).

Moreover, AT&T argues that Verizon's stated preference to remain price regulated in retail markets that rely on special access circuits as inputs, rather than compete at retail with carriers that face the same costs for special access that Verizon does, is a "dramatic illustration of the advantages [Verizon] enjoys in downstream retail markets as a result of its control of special access circuits at the wholesale level" (id.). More specifically, AT&T contends that the only way a grant of pricing flexibility will allow Verizon to increase its retail rates is if its competitors have to pay more than Verizon for the necessary inputs (id.). AT&T argues that Verizon's proposed regulation of private line services is intended to achieve that same result; that is, Verizon will have the ability to raise retail rates while its competitors must pay more than the cost that Verizon incurs for the network facilities necessary to compete (id.). AT&T supports the Department's decision to price special access circuits at the same cost as Verizon incurs so that AT&T can compete for end users in the private line market on a level playing field with Verizon (id. at 5). Indeed, AT&T argues that retail prices for private line services are likely to be driven down by the availability of special access circuits to CLECs at parity with Verizon, and urges the Department to require Verizon to do so, as the resulting decline in retail rates will benefit consumers, rather than allowing Verizon to further inflate prices for private line services (id.).

AT&T also argues that the Department should reject any attempt by Verizon to re-litigate the issue of whether AT&T and other CLECs must use special access circuits to offer private line and other business services (id. at 6). AT&T argues that it devoted substantial resources to submit evidence on this issue, and that the Phase I rebuttal testimony of AT&T's witness Deborah Waldbaum was devoted to this point (id.). AT&T therefore argues that, now, after the Department has "rendered its decision on the basis of uncontested evidence adduced by AT&T," it is too late for Verizon to offer evidence to the contrary (id.).

Likewise, WorldCom argues that Verizon disingenuously asserts that the Department conferred the option of reducing special access rates upon Verizon when, in fact, no choice was given (WorldCom Comments at 1). WorldCom argues that Verizon should not be permitted to circumvent the import of the Phase I Order through the exercise of a nonexistent choice (id. at 2).

3. Analysis and Findings

For the reasons discussed more fully below, we reject AT&T's and WorldCom's arguments that our Phase I Order obligates Verizon to reduce its special access rates and pursue a finding of sufficient competition for private line services, and we reject Verizon's proposal to restructure its retail private line services subject to a 15 percent annual cap.

In our Phase I Order, we denied Verizon pricing flexibility for retail private line services, and said that we would re-price special access "before allowing Verizon upward pricing flexibility for analog and digital private line services." Phase I Order at 62 (emphasis added). In response, Verizon indicated that it would not pursue a finding of sufficient competition for private line services, and would instead have private line services remain subject to price regulation (Phase I Compliance Filing at 3-4).

Although the Department found in its Phase I Order at 61, that Verizon's special access rates constitute a barrier to entry, the sole consequence of that finding was the rejection of pricing flexibility for private line services, not the mandatory re-pricing of special access. The Department's Phase I Order did not require the immediate reduction of special access rates to UNE levels, but rather contemplated a separate showing in order to obtain a finding of sufficient competition for private line services. See Phase I Order at 62. Therefore, Verizon's election to have private line services remain subject to price regulation is fully compliant with our Phase I Order, and unless and until Verizon seeks pricing flexibility for retail private line services, the Department's basis for re-pricing special access circuits will not ripen.

Although Verizon stated in its Phase I Compliance Filing at 4, that private line services would remain subject to price regulation, we determine that Verizon's proposal to raise, lower, or restructure private line services subject to 15 percent annual cap is, in effect, a second request for pricing flexibility and therefore is not compliant with our conclusions in Phase I. Our Phase I Order contemplated that unless special access rates were reduced to UNE levels, there would be no pricing flexibility for private line services, and having denied pricing flexibility for Verizon's private line services, Verizon's rates for private line services will remain frozen until Verizon makes a showing of sufficient competition.

In sum, we determine that Verizon's proposal for regulatory treatment of its private line services in its Phase I Compliance Filing is not in compliance with our Phase I Order, and Verizon is instructed to submit a revised filing consistent with these conclusions.

D. Contestability Using UNEs

1. Introduction

In Phase I of this proceeding, the Department found that for the vast majority of Verizon's retail business services, the supply elasticity is high, and, therefore, the market for those services is contestable. Phase I Order at 67. Therefore, the Department granted Verizon pricing flexibility for those retail business services we found were contestable. Id. at 91. In addition, we directed Verizon to identify other retail business services – other than private line services discussed in the above section – if any, that are not contestable on a UNE-basis. Id. at 61 n.39.

2. Positions of the Parties

a. Verizon

In its Phase I Compliance Filing, Verizon argues that, with the exception of administrative charges (e.g., dishonored check charges, late payment charges, etc., which are charges that a CLEC can apply to their own customers), all of Verizon retail business services can be replicated by competitors via UNEs (Phase I Compliance Filing at 8). Verizon lists its retail business services and the corresponding UNEs that are necessary to provide competing services (id. at Tab C).

Verizon argues that AT&T's assertion that not all of Verizon's retail business services are contestable stems from AT&T's inability to convert existing special access arrangements to

UNEs because of the FCC's restrictions on CLECs' use of UNEs (VZ Reply Comments at 16).[21] Verizon further argues that AT&T fails to meet the FCC's requirements for converting special access to UNEs because AT&T has a significant amount of interstate traffic going over those facilities (id.). However, Verizon asserts that CLECs seeking to provide truly intrastate retail business services do have access to UNE facilities (id.). In addition, Verizon disagrees with AT&T's argument that Verizon's "no facilities, no build" policy[22] inhibits AT&T's ability to compete because "if a facility does not exist, it does not exist for all market participants," including for Verizon (id. at 16-17).

b. AT&T

AT&T argues that Verizon has not shown that its retail business services are contestable, and asserts that none of Verizon's retail business services, except certain services for small businesses, are contestable using UNEs (AT&T Comments at 7; see DTE-ATT 1-1,

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21 The FCC's UNE use restrictions do not require the incumbent local exchange carrier ("ILEC") to convert special access circuits to UNE loops or UNE loop-transport combinations unless the following three criteria are met: (1) the CLEC is the sole provider of local exchange service to the customer; (2) the CLEC certifies that it provides local exchange access and handles at least a third of the local exchange traffic; and (3) the CLEC certifies that at least 50 percent of the activated channels on a circuit are used to provide originating and terminating local dial-tone service, at least 50 percent of the traffic on each of these channels is local voice traffic, and at least 33 percent of the entire loop facility carries local voice traffic. See Supplemental Order Clarification at ¶ 22. These three criteria are known as the FCC's "safe harbors" necessary to avoid UNE use restrictions. See also CompTel v. FCC, 309 F.3d 8 (D.C. Cir. 2002) (upholding FCC safe harbor rules).

22 Under the Telecommunications Act, Verizon is required to unbundle only its existing network. See 47 U.S.C. § 251(c)(3); Iowa Utils. Board v. FCC, 120 F.3d 753, 812-813 (8th Cir. 1997), appealed on other grounds, AT&T Corp. v. Iowa Utils. Board, 525 U.S. 366 (1999). When a CLEC requests UNEs where no network facilities exist, Verizon responds with a "no facilities" classification.

DTE-ATT 2-1, DTE-ATT 2-2).[23] AT&T argues that, because of UNE use restrictions, most of AT&T's business services must be provided over special access circuits (AT&T Comments at 7). Further, AT&T argues that the use of special access circuits is not limited to competing with Verizon's private line services, but rather to provide any bundle of business services that has commercial viability (id.).

AT&T argues that the existing record in Phase I demonstrates the inability of CLECs to obtain UNEs in order to provide services to medium and large business customers (id.). AT&T asserts that just because a CLEC can offer a vertical service using Verizon's switch UNE does not mean that service is contestable; rather, if a CLEC cannot obtain access to an unbundled loop, then that service is not contestable using UNEs (id. at 8). Further, AT&T argues that, although Verizon lists services that require UNE loops in Tab C of its Phase I Compliance Filing, Verizon does not identify under what circumstances those loops are precluded by the UNE use restrictions (id.). For example, AT&T argues that all Verizon loop-transport combinations in an EEL configuration[24] are precluded by Verizon's UNE use

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23 AT&T asserts that CLECs can contest Verizon's retail services that are offered on VG/DS0/POTS circuits, but only if the Department maintains the necessary switching and UNE-P conditions (DTE-ATT 2-2, at 3). AT&T argues that CLECs cannot contest Verizon's retail services on DS1 or above circuits because CLECs must use special access instead, and, thus incur substantially higher costs for the connectivity to the customer premises (through inflated interstate access charges) than does Verizon (DTE-ATT 1-1; DTE-ATT 2-2, at 1).

24 An Enhanced Extended Link ("EEL") configuration consists of a combination of unbundled loop, multiplexing/concentrating equipment, and dedicated transport. AT&T argues that EEL configurations are considered more efficient network designs, where "intervening electronics are inserted to connect the time slot on the EEL facility to the switch only when that time slot is active" and that "this is clearly the most efficient and appropriate network design to handle traffic from multiple customers,

(continued...)

restrictions (id.). AT&T argues that if the business services listed in Tab C of Verizon's Phase I Compliance Filing can indeed be provided over UNE loops and transport without violating UNE use restrictions, then Verizon must be required to make those loops available to competing CLECs (id. at 9).

In addition, AT&T states that Verizon's retail business services cannot be considered contestable as long as Verizon maintains a unilateral "no facilities available" classification, thus invoking the "no build" policy for UNEs (id.). AT&T asserts that CLECs are forced to purchase special access circuits for business services that require interoffice facilities ("IOF"), dedicated transport, or multiplexers because of Verizon's wide latitude in determining the availability of facilities (id.). AT&T argues that because Verizon has not shown that CLECs can obtain all the UNEs necessary to provide competing services without Verizon invoking the UNE use restrictions or "no facilities" classification, the Department must reject Verizon's claim that all of its retail business services are contestable using UNEs (id. at 9, 17).

AT&T argues that CLECs are forced to purchase special access circuits rather than UNEs, and that they must purchase from the higher-priced Federal special access tariff, rather than the intrastate special access tariff (DTE-ATT 2-1, at 5 n.6). AT&T argues that even when Verizon's intrastate special access offering is reduced to UNE levels in conformance with the Department's directives in the Phase I Order (see Section III.C, above), Verizon's retail business services will still not be contestable because CLECs will continue to be forced

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[24](...continued)

[however,] use of this configuration dramatically complicates a CLEC's ability to monitor traffic to collect data needed to take advantage of the second and third safe harbors described in the Supplemental Order Clarification" (DTE-ATT 1-1, Att. A at 14 n.9).

to buy out of the Federal special access tariff at higher prices than Verizon will incur for providing the same services to its retail customers (DTE-ATT 2-1, at 7). AT&T argues that if Verizon were required to apply to CLECs the same policies it applies to its own end-users for determining the jurisdiction of special circuits, then CLECs would be able to purchase the vast majority of special circuits under the state tariff and thus obtain the wholesale input charges that the Department intended in its Phase I Order (id. at 2).[25] Alternatively, AT&T argues that the Department should require Verizon to allow CLECs to purchase the underlying facilities as UNEs, rather than as special access,[26] when CLECs are seeking to contest Verizon's retail services (id. at 10).[27] If either of these two options obtain, AT&T concedes that some of Verizon's retail business services would be contestable (id. at 8).

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25 AT&T argues that this alone would not be sufficient to ensure contestability, but rather a performance assurance plan for special access would also be required, and that Verizon must be prohibited from applying use restrictions on CLEC special circuits and facilities that it does not apply to itself (DTE-ATT 2-1, at 9).

26 Defining the connectivity as "special access" under a regulatory regime that pre-dates the Telecommunications Act of 1996, AT&T argues, raises a host of jurisdictional and regulatory problems, and that defining the connectivity as "UNEs" instead is the most direct way for the Department to exercise jurisdiction over the wholesale inputs (DTE-ATT 2-1, at 3).

27 AT&T suggests that the Department adopt its own "safe harbor" test (similar to the local usage definition recently adopted by the New York Public Service Commission), which would permit CLECs to purchase UNEs to offer business services that compete with Verizon's business services (DTE-ATT 2-1, at 12). AT&T also argues that the Department must then establish transition mechanisms to convert special access to UNEs, provide relief from term and volume penalties in existing payment plans, and prevent Verizon from using its "no facilities, no build" policy to bar further use of UNEs (id. at 10, 12).

3. Analysis and Findings

In Phase I of this proceeding, we investigated the contestability of Verizon's retail business services. As a result of our investigation, the Department concluded that most of Verizon's retail business services, with the exception of private line services, are contestable. Phase I Order at 67. Our inquiry in this phase is to determine whether Verizon has complied with the Department's directive in the Phase I Order to identify whether there are other retail business services, in addition to Verizon's private line services, that are not contestable using UNEs. Verizon argues in its Phase I Compliance Filing that all of Verizon's retail business services are contestable using UNEs, and AT&T argues that, due to the FCC's UNE use and commingling restrictions, Verizon's broad "no facilities" classification, and policies on determining jurisdiction of special access circuits, none of Verizon's business services provisioned on DS1 or above circuits are contestable.

As an initial matter, if we were to accept AT&T's argument that none of Verizon's retail business services are contestable using UNEs, we would, in fact, be adopting a conclusion contrary to the one we reached in Phase I. If AT&T wished to have the Department revisit its conclusion on the contestability of Verizon's retail business services, the proper avenue would have been through a timely-filed petition for reconsideration. Moreover, in responding to AT&T's Motion for Clarification of the Phase I Order, we stated:

> It is Verizon's compliance with the safeguards and conclusions reached in the Phase I Order, as shown in Verizon's [compliance] filing of June 5, 2002, that will be the subject of Phase II, not the taking of further evidence and argument on how additional issues affect competition for Verizon's retail business services. As a result, both AT&T's UNE use restriction argument and commingling argument, which both concern competition for Verizon's retail business services, will not be part of Phase II.

Verizon, D.T.E. 01-31-Phase 1-A at 15, Order on Attorney General's Motion for Reconsideration and Motion for Extension of the Judicial Appeal Period, and AT&T's Motion for Clarification (August 5, 2002) (emphasis added, footnote omitted).

We acknowledge that AT&T's continued interjection of special access provisioning has raised a number of very important issues related to Verizon's special access services, as well as having drawn attention to the fundamental, and sometimes problematic, distinctions between pre- and post-Telecommunications Act regulation. However, we note that most of the arguments raised by AT&T have also been raised in the Department's separate investigation into Verizon's provisioning of intrastate special access services,[28] and we agree with Verizon that that forum, as well as the FCC's ongoing investigation into interstate special access[29] and the FCC's Triennial Review of UNE requirements,[30] provide the proper avenues to seek the remedies for which AT&T argues.

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[28] Investigation by the Department of Telecommunications and Energy on its own motion pursuant to G.L. c. 159, §§ 12 and 16, into Verizon New England Inc. d/b/a Verizon Massachusetts' Provision of Special Access Services, D.T.E. 01-34.

[29] See Performance Measurement and Standards for Interstate Special Access Services, CC Docket No. 01-321, Notice of Proposed Rulemaking, FCC 01-339 (rel. Nov. 19, 2001) ("Special Access NPRM"). In the Special Access NPRM at ¶¶ 13-20, the FCC requested comment on what, if any, measurements, standards, and reporting procedures should apply to ILECs' provisioning of special access services.

[30] Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket 96-98; Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket 98-147; Notice of Proposed Rulemaking, FCC 01-361 (rel. Dec. 20, 2001) ("Triennial Review"). On February 20, 2003, as part of its Triennial Review proceeding, the FCC adopted new rules governing ILECs' unbundling obligations. Although the FCC's final Order has not yet been released, the FCC is expected to address several issues raised by AT&T in this proceeding.

We determine that Verizon has complied with our directives in the Phase I Order to identify whether there are retail business services, other than private line services, that are not contestable. The services listed in Verizon's compliance filing can be purchased in their component parts as UNEs in a manner that allows CLECs to use those UNEs to compete for the final retail product (see Phase I Compliance Filing at Tab C). For these reasons, we agree with Verizon that its retail business services subject to the Phase I Order are contestable.[31]

E. Operation of Price Floors

1. Introduction

In our investigation in Phase I of this proceeding, the Department determined that Verizon may be granted upward pricing flexibility for its retail business services that are contestable on a UNE basis, "but that such a grant must be subject to a price floor equal to the density zone-specific UNE rates underlying the service plus a mark-up equal to the resale discount percentage." Phase I Order at 92. We found that "both the FCC's goal of a transition to facilities-based competition and the Department's goal of economic efficiency will be best served by allowing Verizon upward pricing flexibility for those retail business services that CLECs can compete against with their own UNE-based retail service." Id. at 89.

We determined that allowing Verizon upward pricing flexibility will not harm competitors, and, due to the high supply elasticity of resale and UNEs, competitors could easily respond to an increase in price by Verizon. Id. However, granting Verizon unlimited downward pricing flexibility raised the possibility of Verizon applying a "price squeeze" by

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[31] With regard to AT&T's concerns about the continuation of UNE-P, that issue is also governed by the FCC's Triennial Review.

reducing its retail price until the margin between Verizon's retail price for a service and the cost of the underlying UNE is diminished to the point where Verizon is not covering the costs it charges to its competitors and its own retailing costs so that CLECs cannot efficiently compete with Verizon. Id. at 90. As a result, the Department determined that we will require a UNE-based price floor for Verizon's business services that are contestable on a UNE basis, and will also require Verizon to "file a cost analysis calculating the price floor" when it seeks an initial decrease in price for any retail business service. Id. at 91.

2. Positions of the Parties

a. Verizon

Verizon asserts that the Phase I Order places the burden on Verizon to file sufficient supporting documentation when seeking an initial price decrease for a business service to establish that the applicable price floor is met (Phase I Compliance Filing at 5). Accordingly, Verizon states that, when making an initial filing to reduce rates for a business service, it will include an analysis of the relevant UNE charges for a competitor providing a comparable service plus a retail overhead (id.). Verizon asserts, however, that subsequent filings that rely on the initial price floor analysis should require no additional demonstration if there has been no increase to the price floor inputs (id.). Verizon also asserts that the Department should permit Verizon to demonstrate a "new lower price floor" in subsequent filings when there are "unique circumstances, price decreases of relevant inputs, or other changes that impact the price floor calculation" (id.). If the initial price floor is decreased, Verizon states that it would provide the calculation of the new lower price floor with any filing to reduce rates (id. at 6).

Verizon argues that the price floors required by the Phase I Order are intended to avoid a price squeeze between Verizon retail rates and the wholesale elements used by CLECs to compete with the relevant business retail service (VZ Reply Comments at 17). Verizon also argues that it will include all UNEs needed by a UNE-based CLEC to provide a comparable service plus a retail overhead in its calculation of a price floor, and that the costs Verizon itself incurs in providing the same service are not relevant to the calculation of a proper price floor (id. at 18).

Verizon argues that the Department determined that certain business services are contestable on a UNE basis and that these services are permitted pricing flexibility on a UNE basis and are subject to the enhanced price floor rules (DTE-VZ 2-2). Verizon argues that the enhanced price floor rules do not eliminate the D.P.U. 94-185 rules, but are in addition to the previous requirements (id.).[32] Moreover, Verizon asserts that the establishment of different price floor methodologies for different competitive circumstances conforms to Department precedent (VZ Reply Comments at 19). Verizon further argues that the Department has

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[32] The price floor rules established in Investigation by the Department of Public Utilities on its own Motion into IntraLATA and Local Exchange Competition, D.P.U. 94-185, at 31 (1996) have two sets of requirements, depending on whether or not the incumbent provider controls "an essential input for a competitor's offering of a competing service." For services where Verizon controls an essential input, the price floor consists of "the relevant wholesale rate that at least one competitor pays to [Verizon] in order to offer the service" plus Verizon's "marginal cost of related overhead." Id. (citing Price Cap Order, D.P.U. 94-50, at 205-206 (1995)). For all other services, the Department determined that proper price floor was to be the marginal cost. See Price Cap Order at 206. In a later Order, the Department found that for all of Verizon's retail services (except measured toll services), Verizon could satisfy the price floor requirement by offering these services for resale at the avoided cost discount. D.P.U./D.T.E. 94-185-C at 10 (1997). For measured toll services, Verizon would have to satisfy a marginal cost-based price floor. See D.T.E. 94-185-E (2000).

developed relevant price floors on a case-by-case basis, and that there is no "one-size-fits-all" approach (id.). Verizon argues that all of the retail services listed in Tab A of its Phase I Compliance Filing and its response to ATT-VZ 2-3 remain subject to the price floor rules established in D.P.U. 94-185, while other retail business services, listed in the attachment to Verizon's response to DTE-VZ 2-2, are subject to the enhanced price floor rules established in the Phase I Order (DTE-VZ 2-2; ATT-VZ 2-3).

b. AT&T

AT&T argues that the language that Verizon uses in its Phase I Compliance Filing regarding its price floor obligations differs materially from that used by the Department in the Phase I Order; therefore, Verizon has failed to meet the requirements of the Phase I Order (AT&T Comments at 10). Specifically, AT&T asserts that the Department's price floor requirement can be divided into two parts: one pertaining to the cost of UNEs; and the other to the remaining costs of the retail service (id.).

With respect to the cost of UNEs, AT&T argues that in Verizon's Phase I Compliance Filing, Verizon does not specify that its price floor will include the UNE rates for the elements that make up the retail service as specified in the Phase I Order (id.). Instead, AT&T argues that Verizon only states that its price floor filing will include an analysis of the relevant UNE charges for a competitor providing a comparable service (id.). AT&T submits that Verizon should not be able to limit the UNE costs only to those UNEs that a particular competitor uses, but rather, ought to be required to ensure that its retail price covers the economic costs that Verizon incurs at both the upstream and retail stages of providing the service (id.). In order to accomplish this, AT&T argues that Verizon must ensure that the UNE component of the price floor covers the cost of all the elements it uses in the provision of the service regardless of the number of elements used by a competitor (id. at 11).

With regard to non-UNE costs, AT&T argues that Verizon's use of the term "retail overhead" in its Phase I Compliance Filing does not clearly reveal the fact that the Department required Verizon to use the wholesale discount to reflect the non-UNE costs that Verizon incurs in offering the retail service (id.). AT&T argues that Verizon's filing should be amended to use the same language as the Department and to specify that the retail overhead must be calculated by using the wholesale discount (id. at 12).

AT&T also claims that the issue of price floors in general remains an issue that should be further addressed in Phase II of this proceeding (id.). AT&T argues that while the Department stated in its June 21 Interlocutory Order[33] that it would consider the price floor issue during Phase II of this proceeding, it has not addressed whether price floor rules in D.P.U. 94-185 should continue, except as modified in Phase I, or whether other modifications are warranted (id.). AT&T asserts that although Verizon considers the price floor rules from D.P.U. 94-185 to remain in effect, notwithstanding modifications from the Phase I Order, there was no explicit confirmation of this position by the Department in the Phase I Order (id.). AT&T argues that, at the very least, Verizon should be required to specify which services are subject to the price floor rules in D.P.U. 94-185, and which services are subject to the price floor rules in Phase I of this docket, and that AT&T should be given a further opportunity to contest Verizon's position (id.).

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[33] Verizon, D.T.E. 01-31, Interlocutory Order on Scope (June 21, 2001).

3. Analysis and Findings

The Department agrees with Verizon that the purpose of the price floors required by the Phase I Order is to avoid a "price squeeze." As such, the intent of the price floor is to preserve a margin between Verizon's price of a service and the cost of the inputs required by competitors to profitably provide competing services that is equal at least to Verizon's retailing costs. In this instance, the margin is between Verizon's retail rate for a service and the density zone-specific UNE rates underlying the service (plus a mark-up equal to the resale discount percentage) that CLECs need to compete with Verizon. Therefore, we find that Verizon has complied with the Phase I Order with respect to the calculation of price floors by proposing to impute all UNEs required by CLECs to provide a competing service – rather than the direct costs incurred by Verizon in providing the same service – in its price floor calculations. However, we agree with AT&T that Verizon's use of the term "retail overhead" to designate the mark-up component of a price floor is ambiguous, and so require Verizon to plainly and specifically state that the mark-up included in price floor calculations is equivalent to the approved wholesale discount.

Further, the Department agrees with Verizon that the enhanced price floor rules established in the Phase I Order do not entirely eliminate the need for the D.P.U. 94-185 price floor rules. The pricing flexibility we approved in the Phase I Order is limited to "those retail business services that CLECs can compete against with their own UNE-based retail service." Phase I Order at 89. Indeed, the Department explicitly stated that it will require a UNE-based price floor for "Verizon's business services that are contestable on a UNE basis." Id. at 91. The services identified by Verizon as remaining under the D.P.U./D.T.E. 94-185 requirements (such as toll services, administrative and non-recurring charges, operator services, apartment door answering, and Centrex (see ATT-VZ 2-3)), do not fall into the category of business services discussed in the Phase I Order, and, thus, remain governed by the price floor rules established in our D.P.U./D.T.E. 94-185 proceeding.

F. PAL/PASL, and Other Wholesale-Like Services

1. Introduction

When the Department undertook its investigation into the sufficiency of competition for Verizon's retail business services in Phase I of this proceeding, we identified certain business services that "have historically been treated as retail services . . . but are primarily [ ] or . . . exclusively intended for purchase by other carriers as wholesale services rather than by end-users as retail services." Phase I Order at 36 (footnote omitted). The Department specifically identified Public Access Lines ("PAL"), Public Access Smart Lines ("PASL"), collocation, and special construction[34] as such services, and concluded that Verizon's "evidence of competition for retail services does not provide any guidance as to the level of competition for wholesale services." Id. at 94-95. The Department excluded such services from the pricing flexibility granted to Verizon's retail business services, and required Verizon to identify in its Phase I Compliance Filing any other retail services that are primarily provided to competitive carriers, rather than to end-users, and are thus wholesale in nature. Id. at 95. The

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[34] Verizon provides PAL and PASL to competing providers of payphone service. Collocation occurs when a CLEC locates its equipment within a Verizon central office. Special construction applies when a telecommunications carrier requests a special or unique access arrangement from Verizon that is not available under Verizon's existing tariff.

Department further required Verizon to include in its filing a proposal to price such wholesale services on a UNE basis. Id.

2. Positions of the Parties

a. Verizon

In its Phase I Compliance Filing, Verizon argues that it has calculated rates for PAL and PASL based upon current UNE rates, and estimates that the additional revenue generated from this re-calculation is approximately $345,000 per annum (see Phase I Compliance Filing, Tab B, Att. 1, Workpaper 1). Verizon proposes to use this revenue to reduce the offsets to the residential dial-tone rate created by the Department-ordered re-pricing of access services and collocation (id.). This proposal, argues Verizon, is fully compliant with the Department's Phase I Order, and Verizon references the existing record in the Department's Payphone Docket[35] to assert that it has also complied with applicable FCC requirements regarding its rates for PAL and PASL services (VZ Reply Comments at 22). Verizon argues that the Department should address the PAL and PASL rate issues in the Payphone Docket, rather than in the Department's Phase II investigation in this proceeding, because the record in the Payphone Docket has been extensively litigated and is fully developed (id.). Verizon suggests

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35 Investigation by the Department of Telecommunications and Energy on its own Motion Regarding (1) Implementation of Section 276 of the Telecommunications Act of 1996 Relative to Public Interest Payphones, (2) Entry and Exit Barriers for the Payphone Marketplace, (3) New England Telephone and Telegraph Company d/b/a NYNEX's Public Access Smart-Pay Line Service, and (4) the Rate Policy for Operator Services Providers, D.P.U./D.T.E. 97-88/97-18 (Phase II) ("Payphone Docket"). The Payphone Docket is an ongoing investigation by the Department into Verizon's rates for PAL and PASL.

that when the Department issues its rate determinations in the Payphone Docket, Verizon will incorporate those findings into its alternative regulatory plan (id. at 23).

In addition, in order to comply with our directive to set collocation rates at UNE levels, Verizon seeks to offset the reduction in collocation revenue resulting from the conversion of charges for existing circuits from Tariff M.D.T.E. No. 10 to Tariff M.D.T.E. No. 17 by increasing the residential dial-tone rate "consistent with the revenue-neutral approach adopted by the Department for other reductions in wholesale rates" (Phase I Compliance Filing at 7; see DTE-VZ 2-1). With regard to special construction, Verizon proposes that the pricing of special construction for access services will continue on an individual case basis, as defined in Tariff M.D.T.E. No. 16 (id.). Finally, Verizon states that there are no additional retail business services (other than PAL, PASL, collocation, and special construction) that are provided to carriers and are wholesale in nature (id. at 8).

b. Attorney General

The Attorney General argues that the Department must conduct a thorough investigation to determine if Verizon's estimate of lost revenue for the proposed regulatory treatment of access charges, PAL, and PASL is accurate (AG Comments at 9). The Attorney General argues that Verizon has not adequately explained its re-pricing of collocation or the effect on Verizon's revenue (id. at 11).

c. NEPCC

The NEPCC argues that, while Verizon's rate adjustment for PAL evidences the wholesale nature of this service – rather than its previous retail status – the rate adjustment results in a projected annual increase of $396,128 in Verizon revenue for PAL and a projected decrease of $51,067 in Verizon revenue for PASL (NEPCC Comments at 3). The NEPCC alleges that PASLs are the lines used by Verizon's payphone services, whereas PALs are those used by competitive payphone service providers (id. at 3). According to the NEPCC, the "efficiency" benefits of shifting PAL service to a wholesale-oriented rate are increased overall costs for Verizon's competitors; but for Verizon's own payphone services, the shift means reduced overall costs (id. at 3-4).

The NEPCC argues that Verizon is proposing a local loop rate component for PAL and PASL that is based on a statewide average, weighted according to the four density zones in Massachusetts, for a basic analog two-wire loop (id. at 5). However, the NEPCC contends that this rate does not comply with the FCC's Payphone Orders[36] or the Department's Payphone Docket because this rate is not based on the costs incurred by Verizon that are actually caused by that particular service (id.). Therefore, the NEPCC recommends that the loop component of Verizon's proposed PAL and PASL rates be denied by the Department (id. at 8).

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36 Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, et al., CC Docket No. 96-128, Report and Order, FCC 96-388 (rel. Sept. 20, 1996), Order on Reconsideration, FCC 96-439 (rel. Nov. 8, 1996); aff'd in part and remanded in part sub nom., Illinois Public Telecom. Ass'n v. FCC, 117 F.3d 555 (D.C. Cir. 1997), First Clarification Order, 12 FCC Rcd. 20997 (Com. Car. Bur. 1997), Second Clarification Order, 12 FCC Rcd. 21370 (Com. Car. Bur. 1997), Second Report and Order, FCC 97-371 (rel. Oct. 9, 1997), aff'd in part and remanded in part sub nom., MCI v. FCC, 143 F.3d 606 (D.C. Cir. 1998), Third Report and Order and Order on Reconsideration of the Second Report and Order, FCC 99-7 (rel. Feb. 4, 1999), aff'd, American Public Communications Council, Inc. v. FCC, 215 F.3d 51 (D.C. Cir. 2000); In the Matter of Wisconsin Public Service Commission Order Directing Filings, CPD No. 00-01, Memorandum Opinion and Order, FCC 02-25 (rel. Jan. 31, 2002) (collectively, the FCC's "Payphone Orders").

In addition, the NEPCC argues that Verizon's proposed "UNE-like" unloaded port rate for PAL is higher than the UNE rate for a fully loaded analog port (id.). According to the NEPCC, the Department's Payphone Docket established that the fully loaded analog port is functionally equivalent to the port required for PAL (id.). If the Department is to approve a new PAL port charge, the NEPCC argues that the Department adopt the UNE rate for a fully loaded analog port (id.).

Finally, the NEPCC argues that Verizon is proposing a dramatic increase in the rate it charges for Directory Assistance on both "Unlimited" and "Measured" PAL service (id. at 8-9). The NEPCC alleges that part of this increase results from the costs for "Telco branding,"[37] which "clearly was meant for [CLECs] who may desire the branding" (id. at 9). Payphone providers, argues the NEPCC, have no need for this branding, and, therefore, should not be charged for this service (id.).

3. Analysis and Findings

Our directives in the Phase I Order regarding PAL, PASL, and other wholesale-like services sought to establish regulatory pricing consistency for Verizon's wholesale services on the basis that "lowering all wholesale service rates closer to incremental cost improves efficiency, promotes competition, and creates a consistent economic framework for all wholesale services." Phase I Order at 63. The Department determines that Verizon has complied with our Phase I Order by submitting wholesale pricing plans for PAL and PASL (see Phase I Compliance Filing, Tab B, Att. IV). However, the Department also has an open

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[37] "Telco branding" is an optional service provided by Verizon that identifies a competitive carrier's name with the directory assistance or operator services that are announced to that carrier's end-user.

proceeding – the Payphone Docket – addressing rates for Verizon's PAL and PASL services. Because the Payphone Docket is specifically addressing, inter alia, the pricing of payphone services, and has a fully developed record already established, the Department will defer to that proceeding the responsibility for establishing whether Verizon's proposed rates for PAL and PASL comply with the FCC's Payphone Orders. When that investigation is completed, the Department will require Verizon to incorporate the conclusions of that proceeding into its alternative regulation plan.

In addition, Verizon has complied with our directive in the Phase I Order regarding the re-pricing of collocation circuits and special construction charges for access services; thus, we approve that re-pricing.[38] Verizon proposes that carriers purchasing collocation circuits out of Tariff M.D.T.E. No. 10 have their charges transitioned to the lower rates in Tariff M.D.T.E. No. 17, and that special construction charges for access services remain priced out of Tariff M.D.T.E. No. 16 on an individual case basis (see Phase I Compliance Filing, at 7, and Tab B, Att. V; AG-VZ 2-10). Because Verizon will be pricing collocation from Verizon's UNE rates tariff, we find that Verizon's proposal for collocation is consistent with our finding in the Phase I Order that this service should be priced in a UNE-like manner. Moreover, because special construction charges are unique for each request, the Department finds it inappropriate for Verizon to calculate a uniform tariffed rate for this service. Therefore, Verizon will be assessing special construction costs based on the actual costs Verizon incurs.

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38 We likewise determine that Verizon's proposed re-pricing of its switched access services to interstate levels complies with our directives in the Phase I Order, and, thus, we approve the re-pricing. We discuss the effect of the re-pricing of access services on Verizon's residential services in Section IV.D, below.

Further, Verizon has stated that there are no other retail services that are wholesale in nature (Phase I Compliance Filing at 8). Moreover, no other party to this proceeding asserted that any other Verizon retail services are more properly classified as wholesale services. In reviewing the list of Verizon's retail business services submitted in its Phase I Compliance Filing, Tab A, Att. B, the Department does not consider any other retail business services to be comparable to wholesale services, such as PAL, PASL, collocation, and special construction discussed above. Therefore, we find that Verizon has complied with this requirement of the Phase I Order.

Finally, Verizon proposes to recapture its lost revenue as a result of the re-pricing of collocation circuits through a revenue-neutral adjustment in basic residential services, and to offset this lost revenue by the excess revenue recovered from the re-pricing of PAL and PASL. Because Verizon's proposal affects basic residential service rates, the Department's consideration of this aspect of its proposal is contained in the Track B section of this Order.

IV. TRACK B: RESIDENTIAL SERVICES AND SERVICE QUALITY PLAN

A. Introduction

In our Phase I Order, we characterized our inquiry into the appropriate framework for regulation of Verizon's residential services in the following way: "[W]hat form of Department regulation would (1) ensure just and reasonable rates for residential services, (2) be consistent with our precedent, (3) promote more competition for residential services, and (4) be compatible with our treatment of Verizon's [retail] business services?" Phase I Order at 99. Guided by the series of tentative conclusions the Department outlined in the Phase I Order, Verizon filed its proposal for residential services in its Phase I Compliance Filing. In the evidentiary proceeding examining Verizon's proposal for regulatory treatment of its residential services, the Attorney General, AT&T, and WorldCom suggested modifications to Verizon's proposal.

B. Basic Residential Services[39]

1. Introduction

In the Phase I Order, the Department tentatively concluded that, while some form of alternative regulation would be appropriate for Verizon's residential services, an "inflation minus productivity" price cap may not be the best regulatory mechanism because historic evidence shows that residential rates are likely below their efficient levels. Phase I Order at 100. The Department further suggested that, in order to replicate the range of prices that could prevail in an efficient market, we should allow pricing flexibility for basic residential services within a range encompassing a floor of incremental cost and a ceiling of stand-alone cost. Id. at 102. In addition, in order to promote our ratemaking goal of continuity, we suggested that any price increases for basic residential services should be limited to five percent per year. Id. at 102-103.

2. Positions of the Parties

a. Verizon

Verizon argues that its proposed plan for regulatory treatment of its residential basic services implements the Department's tentative conclusions in the Phase I Order and

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39 Verizon's basic residential services include the residential dial-tone line, measured and unlimited usage, and Suburban, Metropolitan, Circle and Expanded Community Calling services (Exh. VZ-1, at Tab A, Att. A). Verizon's non-basic residential services include all other residential services (id. at Tab B, Att. B).

constitutes an appropriate move toward market-based price regulation that still provides adequate safeguards to ensure that the Department's telecommunications policy objectives will be met (Exh. VZ-3, at 2-3). Verizon states that its proposal for regulatory treatment of residential services permits up to a five percent annual price increase for basic residential services, which is far less than the price increases prescribed by the Department in D.P.U. 89-300 (1990), and is therefore in accordance with the Department's goal of protecting consumers from unwarranted rate shock (id. at 3; VZ Brief at 3). Verizon argues that allowing it to raise rates for basic residential services up to five percent per year prevents real prices from declining (Exh. VZ-3, at 3). Verizon also argues that basic residential prices are "most assuredly below efficient competitive levels" and that maintaining real prices below competitive market levels will impede competitive entry to the detriment of all consumers in Massachusetts (Exh. VZ-3, at 3; see VZ Brief at 2). Verizon asserts that its proposal extends the movement of residential prices toward more economically efficient levels that the Department began with the rate re-balancing process in D.P.U. 89-300 (1990), and that Verizon's proposal facilitates the transition to full market-based pricing (Exh. VZ-2, at 13; VZ Brief at 7).

Verizon argues that cost is not the only basis for pricing retail residential telecommunications services, and states that the Telecommunications Act of 1996 and subsequent federal and state regulations have opened local exchange markets to competition so that market forces must also be an important determinant of price (Exh. VZ-6, at 1; see VZ Brief at 22). While acknowledging that the reasonableness of rates for natural monopolies could be judged with reference to cost, Verizon disputes that natural monopoly conditions prevail in the market for basic residential services in Massachusetts due to the implementation of the Telecommunications Act of 1996 (Exh. VZ-6, at 3; VZ Brief at 22-23). Verizon also explains that because price regulation breaks the link between prices and accounting costs – thus encouraging a regulated firm to behave more like a firm in a competitive market – price regulation is preferable to rate of return ("ROR") regulation (Exh. VZ-6, at 3).

Moreover, Verizon argues that instituting cost-of-service regulation after the Department has established a price cap regime removes the incentives that the Department was trying to create for Verizon in the initial price cap plan, and punishes Verizon for the efficiencies it was able to achieve under price cap regulation by prohibiting it from profiting from those efficiencies; or alternatively, rewards Verizon for inefficiency (Exh. VZ-2, at 14). Verizon also contends that in the Phase I Order, the Department recognized the difficulty of undertaking a cost-of-service investigation for only one set of Verizon customers (i.e., residential service customers), noting that the allocation of joint and common costs shared between business and residential customers "might be unacceptably arbitrary," and argues that cost-of-service regulation might even facilitate the ability of a regulated company to cross-subsidize competitive services with revenues from regulated services (Exh. VZ-2, at 15).

In addition, Verizon argues that the embedded cost analysis offered by the Attorney General "has no relevance whatsoever to the issues in this proceeding" because it is a historical cost analysis that focuses on accounting costs rather than the costs that an efficient firm would face going forward (Exh. VZ-6, at 24; Tr. 1, at 14; VZ Brief at 21). Moreover, Verizon argues that embedded cost analyses of individual services depend on allocations of costs which are not on a cost-causative basis (Tr. 1, at 14). Thus, Verizon argues that historical cost measures "have no relevance to the concept of 'just and reasonable' as it pertains to the price of telephone services provided under regulatory and current market conditions in Massachusetts" and are inconsistent with the principles of competitive pricing on which the Department has stated it could rely to evaluate just and reasonable prices (Exh. VZ-6, at 24; see VZ Brief at 21-22).

Verizon also disputes the Attorney General's claim that the loop is a shared facility whose cost should be allocated to different services because the Attorney General's claim conflicts with the fundamental principles of cost causation (Exh. VZ-6, at 9; see VZ Brief at 26-29). Verizon argues that the local loop is a facility that provides dial tone that enables an end-user to gain connectivity to the public switched telephone network, and that the connectivity provided by the local loop is a pre-condition for access to many usage services (Exh. VZ-6, at 6). Verizon contends that, while the fact that various providers of usage services rely on the local loop to deliver their services to the end-user may lead some observers to arrive at the conclusion that the loop is a shared facility, the local loop is actually an output service that is "demanded in its own right" and must be identified with the full cost that is added to the network when a local loop is placed in service (Exh. VZ-6, at 7). Verizon argues that once a customer acquires a loop, other services can only be made available to that customer at additional cost, and that the cost incurred to provide toll service, for example, to the customer is separate from the cost incurred to provide the loop itself; therefore, the loop cannot be a joint or shared cost (id. at 11; see VZ Brief at 28). Verizon asserts that the manner in which the loop is subsequently used has no bearing on the pricing of the service as cost causation requires the price of a service to reflect the cost incurred to fulfill the demand for the service (Exh. VZ-6, at 8; VZ Brief at 26-27).

With regard to Verizon's basic residential service,[40] Verizon contends that the cost of the loop is incurred when the loop is provisioned, regardless of the actual usage of the loop (Exh. VZ-6, at 9; VZ Brief at 27). Verizon argues that pricing based on cost causation principles will yield prices that are economically efficient; will "result in buying and selling transactions that maximize social welfare;" and that the only measure of cost that reflects the underlying cost caused by a given activity is incremental cost, which is, by definition, prospective and forward-looking (Exh. VZ-6, at 8; see VZ Brief at 28).

Verizon agrees with the Department's assertion in the Phase I Order that any price within the range of incremental cost and stand-alone cost could prevail in an efficient market, but notes that "it is certainly not the case that every price in that range is necessarily Ramsey-efficient"[41] (Exh. VZ-6, at 25, emphasis in original; see VZ Brief at 25). Verizon argues that prices in competitive markets tend to be subsidy-free, i.e., they neither receive nor provide a subsidy and cannot be considered predatory, and also tend to be efficient by being driven by market conditions to being as close to underlying incremental costs as possible (Exh. VZ-6,

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40 Verizon's basic residential service bundles the loop with local usage (Exh. VZ-6, at 9).

41 The concept of "Ramsey-efficient" prices refers to the principles of taxation first articulated by Professor Frank Ramsey and later brought into the regulatory pricing arena (see Exh. ATT-1, at 2). The Department stated in the Phase I Order at 101, "[i]n competitive markets for telephone services, efficient market prices are based on incremental cost plus a mark-up for joint and common costs, based on Ramsey pricing principles . . . [and] pursuant to Ramsey pricing principles, joint and common costs are recovered from services in inverse proportion to the demand elasticity of particular services."

at 25-26). However, Verizon contends that, due to the presence of large shared and common costs in telecommunications, a firm that priced all of its services exactly at their respective incremental costs would never recover the shared and common costs and would not break even or remain viable in the long run (id. at 26). Verizon contends that service prices must therefore be marked up above incremental cost to contribute to the full recovery of shared and common costs (Exh. VZ-6, at 26).

Verizon further argues that the residence dial-tone line charge historically has been priced beneath the economically efficient level, and that pursuant to Ramsey pricing principles – where joint and common costs are recovered from services in inverse proportion to the demand elasticity of particular services – Verizon's residence dial-tone line charge would have increased [were it not for the freeze imposed by the price cap plan], and other basic residential service prices would have also moved toward efficient levels in the presence of increasing competition (Exh. VZ-2, at 8-9). Moreover, Verizon argues that the residence dial-tone line rate increases from 1990 to 1994 exceeded 5 percent per year and that these increases shifted the residence dial-tone line rate towards more economically efficient levels without negatively impacting residential subscriber penetration and created an environment to encourage competitive entry (id. at 10; see VZ Brief at 16-17).

Verizon contends that the Department found existing and growing competition for Verizon's residential services in Massachusetts in the Phase I Order and maintains that this competition constrains its ability to increase prices without limit (Exh. VZ-2, at 11; see VZ Brief at 14). Verizon asserts that consumers will see a benefit from its proposal because competition will drive prices for non-basic residential services down towards economically efficient levels (Exh. VZ-2, at 11). Verizon contends that residential services are not subsidized because each service is priced above the forward-looking direct cost of providing that service (Exh. VZ-6, at 5; VZ Brief at 24). Verizon argues that the rates for basic residential services were determined to be just and reasonable in the Price Cap Order, and that those rates exceeded the marginal cost of each service and provided various levels of contribution (Exh. VZ-5, at 2). Verizon asserts that current rates exceed the marginal cost of each service compared to cost data from Marginal Cost Study VI ("MCS VI") and that comparison with the 1997 TELRIC costs from the Consolidated Arbitrations[42] also yields results that are directionally the same (Exh. VZ-5, at 3; see VZ Brief at 9-10). Moreover, Verizon argues that its analyses of current and proposed rates, and MCS VI and TELRIC costs, illustrate that the residence dial-tone line charge contains less contribution in relation to other services and will still contain lower levels of contribution than usage and vertical services even with the rate changes provided for in the proposed plan (Exh. VZ-5, at 5; see VZ Brief at 24). Nonetheless, Verizon submits that the residence dial-tone line charge covers its incremental cost and is not subsidized in an economic sense (Exh. VZ-5, at 4). Verizon also insists that there is no merit to the claim that competitive services are subsidized by residential services as this contention is based on the Attorney General's erroneous assumption that the local loop is a joint and common facility (Exh. VZ-6, at 24). In addition, Verizon

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[42] See Consolidated Arbitrations, D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94. The Consolidated Arbitrations were the series of Department orders beginning in late 1996, that addressed the consolidated arbitration petitions of NYNEX, AT&T, MCI Communications Company, Sprint Communications Company, L.P., Teleport Communications Group, Inc., and Brooks Fiber Communications.

argues that there has been no demonstration that any competitive service is priced below its forward-looking direct cost and is therefore subsidized (id. at 25).

Verizon argues that while it recognizes that its prices should be required to equal or exceed their corresponding incremental cost price floors, stand-alone cost is "a useful concept in theory, but extremely difficult – perhaps even impossible to implement in practice" because the calculation of the stand-alone cost of any single service out of the range of services derived from networks that depend considerably on shared and common assets is "entirely a matter of conjecture" (Exh. VZ-6, at 26). Verizon also claims that Total Service Long Run Incremental Cost ("TSLRIC")[43] (or, in the absence of TSLRIC data, marginal cost) is the appropriate incremental cost price floor for its basic residential services in order to avoid cross-subsidy (Tr. 1, at 23). Verizon argues that Ramsey pricing principles offer some insight into the pricing of its services in the presence of substantial shared and common costs in competitive markets, and agrees that precise knowledge of individual own-price and cross-price elasticities for all of Verizon services is not essential to ensure that prices move in directions "generally warranted by the Ramsey pricing principle" (Exh. VZ-6, at 28). Verizon argues that the residence dial-tone line is not as inelastic as it may have been before, but it remains the most inelastic element (Exh. VZ-5, at 4; see VZ Brief at 11). Verizon asserts that the margins of contributions from residential services to shared and common costs are the opposite of what one could expect in an efficient market; that is, instead of a relatively

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43 TSLRIC can be roughly approximated as TELRIC minus joint and common costs (Tr. 1, at 36-37; see Exh. VZ-5, at 3).

low percentage markup for residence dial-tone line and a relatively high markup for usage services, the reverse would be expected (Tr. 1, at 25-26; VZ Brief at 9).

Verizon therefore argues that the Department can rely on "rough elasticities" such as order-of-magnitude elasticity estimates and the contribution margins for directional guidance on the movement of residential prices towards efficient levels (Tr. 1, at 26-27). Moreover, Verizon insists that any increase in basic exchange rates is going to increase efficiency for a while given that these ratios of margins are in the opposite direction of what they should be and that "a ceiling for residential basic exchange rate increases of five percent in nominal terms every year isn't going to get you beyond the point of efficiency any time in our lifetimes" (Tr. 1, at 27-28; see VZ Brief at 26). Verizon maintains that the "real virtue" of competition is that efficient or just and reasonable prices need not be arbitrarily selected from the wide range between incremental and stand-alone cost and notes that the presence of viable competitors acts as a policing mechanism that keeps the incumbent's prices in check (Exh. VZ-6, at 26-27).

Verizon acknowledges that even if the relevant elasticities are known and available, implementation of Ramsey pricing principles is still far easier under the "old regulatory break-even constraint" because the firm's revenue requirements are known and the markup in service prices can be carefully calibrated according to the known price elasticities (Exh. VZ-6, at 28). However, Verizon argues that Ramsey-like results can be approximated in a market where the break-even constraint does not apply, and price elasticities are not known exactly, by permitting the market to reveal the sustainable level of markup in each service price (id.; see VZ Brief at 25). Verizon asserts that sustainable prices that simulate the outcomes from a pure Ramsey pricing exercise can be determined by offering customers various combinations of price, volume, and service quality, and letting their preferences reveal the relative strength of demand for each service (Exh. VZ-6, at 28-29; see VZ Brief at 25).

b. Attorney General

The Attorney General argues that Verizon's proposed alternative regulation plan does not achieve the Department's goals of promoting competition, ensuring just and reasonable rates, and maintaining a high level of service quality (Exh. AG-1, at 4). The Attorney General argues that "the reasonableness of rates for regulated public utilities has always been judged with reference to cost" and that Verizon has not provided any recent cost estimates (id.). The Attorney General argues that the Department should not rely on retail cost data from the 1980s as a basis for the pricing of residential services because relying on outdated costs for residential customers would deny these customers the scale and scope economies, as well as the technological changes and merger savings, which have occurred over the past fifteen years and which have been factored into wholesale rates (id. at 4-5, and n.8). The Attorney General further argues that raising residential rates without any cost justification would not ensure that the rates reasonably approximate what would be found in a competitive market (id. at 5). The Attorney General argues that without knowing total costs, efficient prices cannot be determined because it is unknown whether the proposed prices exceed costs (Exh. AG-2, at 6).

In order to ensure that the rates for residential dial-tone services represent "true costs" and are just and reasonable, the Attorney General recommends that the Department freeze the residential rates at their current levels and open a new docket to conduct a cost-of-service study to determine if Verizon's rate of return is adequate or exorbitantly high (Exh. AG-1, at 33). The Attorney General argues that the Department cannot "talk about Ramsey efficient pricing without identifying what is the revenue goal of that pricing exercise" (Tr. 2, at 182). Further, the Attorney General argues that "until the Department renounces that goal [of adopting Ramsey-efficient prices], they need to undertake this embedded cost study" (id. at 183).

According to the Attorney General, in the cost-of-service study submitted in D.P.U. 89-300 (1990), Verizon demonstrated that an increase in residential rates would be necessary if revenue from other service areas were decreased in order "to equalize the class rate of returns" (Exh. AG-1, at 6). The Attorney General argues that because rates and costs have changed since then, it is no longer valid to assume residential rates continue to be subsidized, and that new cost information must be analyzed to determine if any subsidies exist in the residential rate (id.). However, the Attorney General concludes that Verizon's basic residential rates are not subsidized because Verizon's current residential rate for basic unlimited local service exceeds the sum of Verizon's current UNE rates and marginal cost (id. at 8; Tr. 2, at 180-181, 211).

In addition, the Attorney General states that Verizon has not submitted any cost or demand data to determine if its proposed price increases would be efficient, and argues that Verizon's alternative regulation proposal is inconsistent with economic efficiency (Exhs. AG-2, at 4; AG-1, at 16). The Attorney General states that while competitively efficient prices can be expected to lie between stand alone and incremental costs, it is not true that any price between stand alone and incremental cost will therefore be efficient (Exh. AG-1, at 16-17).

The Attorney General claims that defining "efficiency" broadly as the range between stand alone and incremental cost could result in the discriminatory treatment of different classes of customers and "violate the DTE's definition of fairness" by charging one class of customers the stand alone cost and another the incremental cost (id. at 17). According to the Attorney General, firms in a competitive market often take into consideration a strategy of segmented pricing, such as peak-load and service bundles, which implies the existence of a much more dynamic and fluid pricing environment than one in which prices are merely driven to incremental cost (id. at 23-24). As an example, the Attorney General states that this pricing environment exists in the cable and wireless markets (id. at 24-27).

The Attorney General argues that, contrary to Verizon's assertions, increasing the price of residential service may slow market penetration (Exh. AG-2, at 10). The Attorney General argues that Verizon's reliance on the FCC data measuring the impact of prices on residential subscriber penetration levels in Massachusetts from 1990-1994 is overstated because consumers respond to price changes gradually, over a longer period of time than is represented by Verizon (id. at 11). The Attorney General contends that Verizon fails to take into account the overall decline in Massachusetts market penetration which occurred from 1993 to 2000 (id. at 12).[44] In addition, the Attorney General states that elasticities can only be estimated by holding all other things constant, but Verizon's penetration data did not account for the changes that occurred within the study period, such as rate decreases in other

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44 The Attorney General asserts that, according to FCC data, the penetration rate for local service in Massachusetts gradually declined from a high of 97.4 percent in 1993 to a low of 94.0 percent in 2000, before rebounding to 95.9 percent in 2001 (Exh. AG-2, at 12).

telecommunications services and demand shifts resulting from the expansion of internet services (id. at 13-14).

The Attorney General argues that in some competitive markets, efficient prices are based on incremental cost plus a mark-up, which is derived from Ramsey pricing principles, to recover joint and common costs (Exh. AG-1, at 19). The Attorney General argues that while it is possible to determine demand elasticities, it would be unrealistic for regulators to estimate all the own-price demand and cross-price demand elasticities necessary to implement Ramsey prices (id. at 20). According to the Attorney General, this is because the demand elasticities for services are interrelated, such that if prices are changed, complementary services are affected (Tr. 2, at 219). The Attorney General argues that while the basic insights of Ramsey pricing can be applied to set efficient prices, Ramsey pricing principles hold true only under special circumstances, such as when service demands are independent (Exh. AG-1, at 19, 20; Tr. 2, at 198). The Attorney General argues that access to the telecommunications network is not an independent demand, but rather a derived demand, meaning that consumers seek access for placing and receiving calls, not for access independent of those services (Tr. 2, at 214).

In addition, the Attorney General argues that loop costs should not be recovered solely from residential dial-tone because the loop is a shared facility (Exh. AG-1, at 9). The Attorney General claims that Verizon's proposal to recover 100 percent of the loop cost from the end-user rests on two propositions: (1) the loop is a separate service; and (2) the loop is a dedicated non-traffic sensitive cost (id.). According to the Attorney General, the FCC supports the Attorney General's contention that the loop is an input into the production of almost all other telecommunications services, not a separate service (id.). The Attorney

General argues, therefore, that loop costs should be shared among all of the services utilizing the loop facility (id. at 10). Furthermore, the Attorney General argues that the addition of electronics such as digital loop carriers[45] converts the loop into a traffic sensitive facility, contrary to Verizon's position (id. at 11).

Additionally, the Attorney General points out that new technology and network configurations enable the loop to carry more advanced non-voice services, such as digital subscriber line ("xDSL") (id. at 28). The Attorney General argues that because the loop allows carriers to have multiple revenue streams,[46] the entire revenue stream should be taken into account in the recovery of the cost of the loop facility (id.). The Attorney General argues that for these reasons, allowing Verizon to recover the full cost of the loop from flat end-user dial-tone rates is no longer providing the correct signal to end-users and investors (id. at 11). Moreover, the Attorney General argues that Verizon's own witness, Dr. Taylor, agreed in a case before the New Mexico Public Regulatory Commission, that in a line sharing or line splitting arrangement, the costs of the loop are fixed costs between the two arrangements and

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[45] A digital loop carrier ("DLC") commingles traffic from multiple copper loops onto a fiber loop at a terminal between the end-user and the serving central office. The amount of traffic concentrated at the DLC is determined by a concentration ratio, which is a "function of the traffic load to be carried" (Exh. AG-1, at 11). According to the Attorney General, because the fiber portion of the loop is not a dedicated path between an end-user and central office, but carries commingled traffic from multiple end-users to the central office, the fiber portion of the loop is traffic sensitive (id.).

[46] The Attorney General argues that multiple revenue streams over a single loop can occur, for example, from vertical services and line sharing or line splitting arrangements, where voice services are provisioned over the low-frequency portion of the loop and non-voice data services are provisioned over the high-frequency portion of the loop (Exh. AG-1, at 28).

should be shared, contrary to the position that Verizon has taken in this case (Tr. 2, at 254; see Exh. AG-6).

Further, the Attorney General argues that section 254(k) of the Telecommunications Act requires states to allocate the cost of the loop to all the services that use the loop in order to ensure that services defined under universal service do not bear an unreasonable portion of the joint and common costs of that shared facility (Exh. AG-1, at 31-32). The Attorney General argues that recovering 100 percent of shared costs from the dial-tone rate is neither pro-competitive nor pro-consumer for two reasons (id. at 21). First, the Attorney General argues that "competition is not good for its own sake" because artificially high prices will result in inefficient firms profitably entering the market (id. at 22). Second, the Attorney General claims that artificially high prices for dial-tone will result in lower prices for other services, thus thwarting competition in those markets (id.).

c. WorldCom

WorldCom states that it does not oppose Verizon's proposal for regulation of Verizon's residential services, provided that the Department adopts two modifications to the proposal (WorldCom Brief at 1). First, WorldCom argues that the Department should require Verizon to further reduce its intrastate switched access charges from the current level of interstate rates (as mandated in the Phase I Order) to TELRIC over a three year period (id. at 2-3). Second, WorldCom argues that the Department should suspend Verizon's rate flexibility for basic residential service if the level of residential competition is "frozen" or reduced as a result of changes in regulations concerning the availability of UNE-P now being considered by the FCC (id. at 3-4). The Department should retain the authority, argues WorldCom, to terminate all or part of the alternative regulation plan if market conditions warrant a suspension of the flexibility contained within the plan (id.).

d. AT&T

AT&T asserts that local exchange telephone companies were traditionally subject to ROR regulation, under which the regulator first determined the size of the company's capital base and then calculated rates for the company's various services in order to achieve the "fair" rate of return on those assets (Exh. ATT-1, at 7). AT&T asserts that regulators set rates for basic residential local exchange telephone service residually under ROR regulation; in other words, regulators set rates for other services at well above cost, and then set rates for residential local exchange service as low as possible to attain the target return (id. at 8). This pricing methodology, argues AT&T, led to largely inefficient prices for the portfolio of telephone services offered by the local exchange company (id.). Moreover, AT&T argues that the adoption of price cap regulation did not halt the inefficient pricing of local exchange and access services because, for the most part, the initial prices established for the firm's regulated services were those that prevailed under ROR regulation (id. at 9). AT&T maintains that subsequent adjustments for inflation and productivity gains did not address the fundamental pricing distortions brought about by residual pricing, and that residential local exchange rates continued to be priced at levels below those warranted by economic efficiency (id.).

However, AT&T argues that conducting a traditional cost-of-service study would have limited and questionable value for setting local residential rates because the allocation methodologies of such an approach produce costs and rates that are inconsistent with cost-causation principles (Exh. ATT-2, at 2). AT&T argues that earlier cost-of-service studies are outdated, and that the Attorney General's calculations are based on several assumptions, and are far too imprecise for the Department to base findings on whether the price of residential service exceeds its costs (id. at 3-4; see AT&T Brief at 9-13). As a result, AT&T suggests that it is not clear whether Verizon's basic residential service is no longer subsidized (Exh. ATT-2, at 6). Moreover, AT&T alleges that the "anemic" competitive interest in residential markets in Massachusetts provides some amount of prima facie evidence that residential prices are too low, but also notes that "the attractiveness of entry is driven not only by output prices but also by the ability of new entrants to secure inputs at efficient prices and under nondiscriminatory terms" (id. at 6-7; see AT&T Brief at 13-14).

Furthermore, AT&T asserts that the Attorney General's argument that the relevant cost against which residential rates should be benchmarked should not include the entire cost of the loop is without merit since it is based on "a mistaken economic perspective" (Exh. ATT-2, at 3, 7). AT&T argues that the Attorney General's argument violates the "fundamental tenets of efficient costing and pricing," and is inconsistent with principles of cost causation (id. at 7). In particular, AT&T argues that dial-tone access is "demanded in its own right" and the costs of providing that access, including the costs of the local loop, can readily be identified with the provision of such access; thus, AT&T argues that the incremental cost of providing that access should be recovered in the monthly fixed charge (id. at 7-8). AT&T also asserts that, contrary to the Attorney General's claims, the incremental cost of dial-tone is neither zero nor very close to zero (id. at 9). AT&T explains that in a network industry, where access to the network is the primary service, the incremental cost of access should be computed before that of other services that rely on access to the network (id.). AT&T argues that, when properly calculated in this manner, the incremental cost of access is identified on a cost-causative basis and is not shared among other services (id.).

AT&T asserts that the Telecommunications Act of 1996 transformed the fundamental role of regulatory commissions to one of developing "a set of competition-enabling policies that will allow for the introduction and development of competition" so that, as competition grows and becomes effective, markets can replace regulation as the primary source of protection of consumers (Exh. ATT-1, at 11). AT&T argues that residual pricing of residential local exchange services must cease because the imposition of residually determined, artificially low rates is inefficient and discourages the establishment of competition in telecommunications (id. at 12). AT&T argues that prices that do not, at a minimum, recover the incremental cost of providing the service constitute a regulatory barrier to entry that deters the introduction and growth of competition (id. at 13; AT&T Brief at 29-30).

While AT&T considers the range between incremental cost and stand-alone cost for pricing flexibility proposed in the Department's tentative conclusions to be "appealing" to the extent that prices outside the range would be inefficient and "arguably unfair," AT&T contends that there are important reasons to narrow this range further (Exh. ATT-1, at 16). At the top of the range, AT&T asserts that the stand-alone cost of providing residential local exchange is likely to be quite high and would "certainly allow for the extraction of considerable amounts of consumer surplus" (id. at 17). On the other hand, AT&T argues that where the prices Verizon charges to competitors for necessary inputs remain above the incremental cost of the input to Verizon, denoting a price floor at Verizon's incremental cost "creates the very real prospect that efficient competitors will be artificially excluded from [the] market" (id.; see AT&T Brief at 9). Therefore, AT&T recommends that the low end of the range should reflect the cost Verizon imposes on its competitors for all of the monopoly inputs, plus Verizon's retailing costs (Exh. ATT-1, at 17).

AT&T argues that the Ramsey pricing principles suggested by the Department as the basis upon which recovery of joint and common costs might be recovered in its Phase I Order, "are sound and may guide decisionmaking," but contends that caution should be exercised before applying them as they are meant to be applied specifically to a declining-cost, regulated natural monopoly (id. at 25). AT&T argues that in such an industry, "the first-best efficient price" is marginal cost, but that the revenues resulting from pricing at marginal cost are insufficient for the firm to recover all its costs (id.). Therefore, AT&T argues that prices must be marked up from the economically efficient level for the firm to recover joint and common costs as well as its marginal costs (id.). AT&T argues that Ramsey pricing principles advise that the efficient set of mark-ups should vary inversely with the price elasticity of demand for the firm's various service offerings in order to minimize distortions to economic efficiency (Exh. ATT-2, at 10; see Exh. ATT-1, at 25).

Nevertheless, AT&T disagrees with the Attorney General's fundamental challenge to the implication of applying Ramsey-based inverse elasticity guideposts to pricing for residential exchange service (Exh. ATT-2, at 10). More specifically, AT&T objects to the Attorney General's speculation regarding whether the residential dial-tone line charge is still the most inelastic price element or not, and the Attorney General's consequent assertion that the mark-up over marginal cost for the dial-tone line charge should be somewhat similar to the mark-up for other telecommunications services (id. at 11). AT&T contends that a "large and robust econometric literature" suggests that the demand elasticity for residential dial-tone access is highly inelastic in both an absolute sense and relative to other telecommunications services (id.; see Exhs. ATT-3; ATT-4; ATT-5). AT&T therefore argues that there will likely be minimal efficiency losses from raising basic residential rates and that universal service concerns can be addressed effectively through a complementary policy of targeting assistance to those households in need of assistance (Exh. ATT-2, at 12; see also Exh. ATT-6 (showing the decline of the dial-tone line charge in real terms and as a percentage of income)).

AT&T also argues that fundamental economic principles require that retail, not wholesale (or input) prices be raised above economically efficient levels in order to recover joint and common costs (Exh. ATT-1, at 26). AT&T therefore recommends that the Department devote its attention to pricing inputs at economically efficient levels (i.e., TELRIC pricing for switched access (see AT&T Brief at 4-7)) and establishing a price-escalator cap for Verizon's residential retail services, rather than applying through regulatory fiat a set of pricing principles that may be inconsistent with the underlying assumptions of the Ramsey model (Exh. ATT-1, at 26). AT&T argues that this approach will foster competition and let the market, not regulators, determine the appropriate contribution from each service to the recovery of the firm's joint and common costs (id. at 27). However, AT&T argues that the economic rationale for the economically efficient pricing of inputs and the establishment of "generally subsidy-free" retail residential rates are independent and have "no logical connection" to each other in a regulatory framework of enabling competition (id.). AT&T recommends that the Department should not concern itself with how Verizon may recoup revenue losses in one area with price increases in another because, while that logic may have been pertinent to residual ratemaking, it "sacrifices both economic efficiency and competition" in the current transition to a competitive residential marketplace in Massachusetts (id. at 25-26).

AT&T does not consider the Department's tentative conclusion in the Phase I Order to limit residential price increases to no more than five percent per year to be unreasonable, as this price-escalator cap ensures minimal disruptions to consumers (Exh. ATT-1, at 18). However, AT&T expresses concern that the five percent limit might be an impediment to competition in Massachusetts because it may restrict Verizon from setting retail residential rates that reflect the economic cost of providing basic residential service (id.). AT&T therefore suggests that the Department consider a ten percent per year limit on rate increases for basic residential service for the next three years as this would allow Verizon to set rates more likely to reflect the economic cost of providing the service (id. at 19; see AT&T Brief at 14-15, 21).

AT&T argues that if the Department agrees with AT&T's suggestion, it is critical for the Department to ensure that inputs essential for new entrants to compete are correctly priced at their economic cost so that competitors may provide a meaningful check on Verizon's upward pricing (Exh. ATT-1, at 19-20). Therefore, AT&T urges the Department to examine retail residential rates and the rates for the UNE inputs required to provide the retail service, and remedy the situation if retail rates are found to be below UNE rates, as the Department stated it would do in the Phase I Order (id. at 21). AT&T emphasizes the necessity of requiring Verizon to set its retail prices at or above the TELRIC-based UNE costs of providing the service plus its retail overhead, regardless of the pricing flexibility afforded

Verizon (id. at 21-22). Finally, AT&T concludes that permitting moderate rate increases for retail residential rates as part of a larger strategy of enabling competition is likely to yield lower rates in the long run, as robust competition will drive costs down, and produce rates lower than can be expected under "a regime of monopoly regulation or anemic competition" (Exh. ATT-2, at 13).

Finally, AT&T argues that the best means of protecting consumers from economically unjustified basic residential price increases is to facilitate competitive alternatives to Verizon's basic residential service (AT&T Brief at 23). Therefore, argues AT&T, the Department should make clear that a grant of residential pricing flexibility to Verizon will be conditioned on the ability of CLECs to compete in the residential market, which is in turn dependent on CLECs' continued access to UNE-P and the full voice and data capability of fiber fed loops (id. at 23-24).

3. Analysis and Findings

a. Introduction

Our statutory responsibility requires us to ensure that rates for common carrier telecommunications services in Massachusetts are just and reasonable. G.L. c. 159, §§ 14, 17, 20. Over time, the Department has satisfied this statutory mandate in different ways as the relevant statutes do not prescribe any single method. See Phase I Order at 17-19. Most recently, in our Phase I Order in this proceeding, we determined that market forces could be relied upon to produce just and reasonable rates for Verizon's retail business services, as those services are subject to competition sufficient to keep prices at a reasonable level. Id. at 93. Verizon has not sought a similar determination with regard to its basic retail residential services; therefore, we have not investigated Verizon's proposal with an eye towards whether there is sufficient competition for Verizon's basic residential services to rely on market forces to ensure that rates for these services are just and reasonable. Rather, the question that the Department investigated in this phase of the proceeding is what form of regulation would be appropriate for Verizon's basic residential services going forward.

As discussed above, the Attorney General argues that the Department should continue the rate freeze and open a new proceeding to examine the costs that Verizon incurs in provisioning residential services, based on a traditional, rate case review of Verizon's historic costs (Exh. AG-1, at 2).[47] Verizon, guided by the Department's tentative conclusions in the Phase I Order, proposes that basic residential prices fall within the range between incremental cost and stand-alone cost, subject to a five percent annual cap on rate increases (Exh. VZ-6, at 25). AT&T argues that Verizon's basic residential rates should be subject to a price floor that reflects the costs Verizon imposes on competitors for inputs necessary to provide a competing service plus Verizon's retailing costs, rather than the incremental cost Verizon incurs to provide the service itself, and suggests that a ten percent annual cap on rate increases

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[47] In his Brief, the Attorney General also suggested that the Department order an independent audit of Verizon's regulatory accounting (AG Brief at 29-30). This suggestion was a repeat of an earlier request made by the Attorney General in his appeal of the Track B procedural schedule. When the request was first made, the Department stated that the Attorney General must prove the need for such an audit as part of an evidentiary showing in Track B. See Verizon, D.T.E. 01-31-Phase II, at 6, Interlocutory Order on Appeal by the Attorney General of Hearing Officer's Ruling on the Procedural Schedule (September 3, 2002). Although the Attorney General did put on a direct case and sponsor an expert witness in Track B, nowhere in his direct case is there any mention of the need for an independent audit of Verizon's regulatory accounting or evidence to support such a request. Therefore, the Department does not grant the Attorney General's request.

might be necessary to enable Verizon to set retail rates that recover the economic cost of providing basic dial-tone line service and attract competitive entry (Exh. ATT-1, at 17, 26).

For the reasons discussed in detail below, we determine that it would not be consistent with the Department's goal of rate continuity to establish a floor of imputed incremental costs plus retailing costs for basic residential services. Establishing such a price floor could require over a $6.00 per month increase in the residential dial-tone line rate.[48] However, in order to move basic exchange rates closer to economically efficient levels and improve conditions for local exchange competition, while meeting our statutory obligation to ensure just and reasonable rates, we determine that a one-time increase of $2.44 in Verizon's dial-tone line charge is warranted at this time, with no further pricing flexibility absent a Verizon demonstration of sufficient competition.

b. Cost-of-Service

As an initial matter, we disagree with the Attorney General's proposal to continue the rate freeze for basic residential services and conduct a cost-of-service study. The Attorney General's recommendation is based on his assertion that "there is no cost data that justifies an increase in the price of residential service," and his position that Verizon's proposal violates two fundamental regulatory principles: (1) the prohibition against raising rates without current supporting cost data; and (2) the requirement that rates reasonably approximate what would

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48 As discussed further below, this estimate is derived using the new UNE rates proposed by Verizon in its February 13, 2003 compliance filing in the Department's UNE Rates Proceeding, D.T.E. 01-20. Pursuant to 220 C.M.R. § 1.10(3), the Department incorporates this material from the D.T.E. 01-20 record for illustrative purposes in supporting its conclusions regarding the interplay between UNE rates and Verizon's basic residential service rates.

obtain in a competitive market (Exh. AG-1, at 5). As discussed below, we disagree with the Attorney General's choice of historic costs as the appropriate standard. Further, we do not share the Attorney General's position that any increase in basic residential rates without a traditional cost-of-service study violates our regulatory goals or Massachusetts statutory requirements.

Prior to 1995, the Department regulated Verizon using a rate of return model, under which Verizon's aggregate revenue requirements were calculated based on its recorded costs in an historic test year, including a fair rate of return on its capital base. This method has been commonly referred to as "cost plus," (i.e., revenues equal historic costs plus a return on investment). Once the revenue requirement was established, prices for individual services were then determined on the basis of historic billing determinants in order to equal the approved revenue requirement. It is important to note, though, that prices for individual services calculated in this manner were not required to have any connection to either cost causation or equalization of rates of return from specific services or customer classes. See D.P.U. 89-300, at 10-16 (1990). Long-distance, toll, and business rates were priced above cost in order to subsidize basic residential services, which were priced below cost to promote universal service.[49] See D.P.U. 93-125, at 4 (1994).

As noted, the rate structure used to recover the revenue requirement often had little or no relation to marginal or incremental costs. In other words, the statutory mandates that rates be just and reasonable and result in reasonable compensation for the service provider (see G.L.

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[49] Universal service means that the rate structure for telecommunications companies ensures rates that allow basic telecommunications services to be obtained by the vast majority of the state's population. D.P.U. 89-300, at 12 (1990).

c. 159, §§ 14, 17, 20) were satisfied only in terms of the overall revenue requirement. Similarly, a "general increase in rates" has been interpreted to mean an increase in the regulated company's overall revenues – rather than an increase in a particular rate element – which triggers the notice, hearing, and other obligations contained in G.L. c. 159, § 20, pertaining to general rate increases.[50] See Price Cap Order at 219-220.

Further, given that business services have already been granted upward pricing flexibility in our Phase I Order, and non-basic residential services have been subject to market-based pricing since the Department's first rate re-balancing order (D.P.U. 89-300 (1990)), the Department recognizes that conducting an embedded cost-of-service study today for only one set of Verizon customers would be difficult and, more importantly, would not produce an economically rational result. This is because the allocation of joint and common costs shared between business and residential services, as well as basic and non-basic residential services, would be unacceptably arbitrary (see Exh. VZ-2, at 15). Moreover, we agree with AT&T that the allocation methodologies of a cost-of-service study often result in rates and costs that are inconsistent with cost-causation principles (Exh. ATT-2, at 2). In addition, unlike forward-looking economic costs, embedded costs focus on historic accounting costs instead of the costs that an efficient firm would face going forward (Exh. VZ-6, at 8 and n.4, 24). We also remain concerned that cost-of-service regulation may facilitate a regulated company's ability to cross-subsidize competitive services with revenues from regulated services (see Exh. VZ-2, at 15). Phase I Order at 99.

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50 For example, non-dominant carriers have raised rates for particular services numerous times since 1985 without triggering the G.L. c. 159, § 20 requirements for notice and a hearing.

The Department has previously noted that the "simulation of the results of a competitive market is a principal goal of regulation" (Price Cap Order at 105), and found that we could "look to principles of competitive pricing to judge whether regulated prices for specific services are just and reasonable." Phase I Order at 101. We agree with Verizon that prices in competitive markets tend to be subsidy-free and efficient in that they are driven as close to their underlying costs as possible (Exh. VZ-6, at 25-26). We also agree that incremental cost is the only measure of cost that is forward-looking and reflects the underlying cost caused by a certain activity (id. at 8). Embedded cost analysis, on the other hand, is a historical cost analysis that is not compatible with principles of market-based, forward-looking pricing (id. at 24). See D.P.U. 89-300, at 13, quoting IntraLATA Competition Order at 38 ("[P]roperly defined marginal costs 'represent the most efficient costs to be considered for pricing services as competition enters a marketplace,' and, therefore, are consistent with the Department's goals of economic efficiency and fairness"); Price Cap Order at 108-112, 128 ("The Department is not abandoning its long-standing commitment to competition in telecommunications, so the promotion of allocative efficiency must and should [continue to] be important . . ."). See also Verizon Communications, Inc. v. Federal Communications Comm'n, 535 U.S. 467, 122 S. Ct. 1646, 1665-1667 (holding that 1996 Telecom Act does not require that TELRIC rely on historical costs for developing forward-looking rates).

Moreover, we determine that our statutory mandate does not require us to conduct a cost-of service study of Verizon's basic residential services. G.L. c. 159 does not differentiate between dominant and non-dominant carriers, CLECs and ILECs, LECs and interexchange carriers, etc. Our obligations under chapter 159 apply equally to every common carrier.

Therefore, any argument to the effect that we are legally required to take certain measures in regulating Verizon, but not in regulating all other common carriers, is incorrect. For example, if we are legally required to conduct a cost-of-service evaluation to determine that Verizon's rates are just and reasonable, as argued by the Attorney General, then we must conduct the same evaluation for every common carrier. In fact, it is the opposite of this argument that is correct – if it is legally permissible to rely on market forces or non-revenue-requirement-based cost measures to determine that other common carriers' rates are just and reasonable, as we have done for all non-dominant carriers since 1986 pursuant to the IntraLATA Competition Order, then it is legally permissible to do so for Verizon's residential services as well. And, where we do decide to use a cost standard for judging whether rates are just and reasonable, we are free to choose the appropriate cost standard, whether it be fully-allocated, historic cost, marginal cost, TELRIC, or TSLRIC. See American Hoechest Corp. v. Department of Pub. Utils., 379 Mass. 408, 413 (1980) ("[W]hen alternative methods are available, the department is free to select or reject a particular method as long as its choice does not have a confiscatory effect or is not otherwise illegal"); New England Tel. & Tel. Co. v. Department of Pub. Utils., 371 Mass. 67, 71 (1976) (holding that although the Department is not required to use a method based on an adjusted historic test year in rate proceeding, it is permitted to do so).

c. Continuation of Price Cap

In addition, we determine that a price cap methodology for regulating Verizon's basic residential services is unwarranted. In 1995, the Department determined that price cap regulation would be superior to ROR regulation in terms of benefits to both ratepayers and

Verizon (then, NYNEX) because price cap regulation promotes technical efficiency[51] by providing the regulated firm with the types of incentives found in a competitive marketplace. Price Cap Order at 110-111. The Department also decided to terminate the transitional rate re-balancing process before the target rates discussed in D.P.U. 89-300 (1990) were achieved and initiated a freeze on basic residential service rates for the duration of the price cap plan. However, because an "inflation minus productivity" price cap is designed to control the aggregate prices and earnings of a regulated company, and not to determine just and reasonable rates for any particular rate element,[52] we determine that continuation of "inflation minus productivity" price cap regulation is unlikely to yield efficient prices for Verizon's basic residential service going forward. See Phase I Order at 101.

d. The Appropriate Cost Standard

As stated above, we can look to principles of competitive pricing to assess whether rates for individual services are just and reasonable. Due to the presence of large shared and common costs, efficient market prices in competitive markets for telephone services are based on incremental costs plus a mark-up for joint and common costs pursuant to Ramsey pricing principles, where joint and common costs are recovered in inverse proportion to the demand elasticity of particular services. See Price Cap Order at 249 n.144.

The Department agrees with the Attorney General that it would be unrealistic for "regulators to estimate all the own-price demand and cross-price demand elasticities necessary

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51 "Technical efficiency" is the measurement of the value of resources expended to produce goods and services. Price Cap Order at 108.

52 An "inflation minus productivity" price cap is not a tool of rate design; rather, it is akin to the establishment of a revenue requirement.

to implement Ramsey prices" (Exh. AG-1, at 20). Verizon also asserts that "it is practically impossible to obtain precise measurements of price elasticity in a dynamic competitive market" (VZ Brief at 12). We have also previously noted that it is "impractical for regulators to determine demand elasticity (and, thus, efficient mark-ups) for any specific service." Phase I Order at 101.

However, we agree with Verizon that precise knowledge of individual own-price and cross-price elasticities for all of Verizon's services is not necessary to move prices toward efficient levels (Exh. VZ-6, at 28). There was no disagreement among the economists testifying in this proceeding that Ramsey pricing principles require rates that "place greater responsibility for the recovery of joint and common costs on services having the lowest elasticities of demand" (VZ Brief at 10). Persuasive expert testimony in this case, and the econometric literature submitted by the parties in this proceeding, show that the demand for basic residential service is very inelastic, and likely very close to zero (see Exh. DTE-ATT 4-1; AT&T Brief at 20). And the evidence presented by both AT&T and Verizon suggests that the demand elasticity for usage-based services is considerably higher, perhaps even several orders of magnitude higher (see Exhs. AG-VZ 1-1; DTE-ATT 4-1).

The Attorney General concurs that basic residential services historically has been the least elastic service offered by a telephone company, and we are persuaded that the alternative services that have emerged as substitutes for Verizon's basic residential service (e.g., wireless and cable telephony) also serve as substitutes for Verizon's usage and other services, and have not significantly altered the price elasticity for basic residential service relative to these other services. Thus, we can reasonably conclude that, in comparison to usage-based services, basic residential service remains the most inelastic service. Indeed, using a strict application of Ramsey pricing principles (with efficiency as the only consideration), the order of magnitude difference between the elasticity estimates for basic residential service and usage-based services would require the assignment of almost all joint and common costs to basic residential services. In fact, assignment of all joint and common costs to the most inelastic rate element was the basis for the illustrative tariffs that guided the Department's decisions on rate re-balancing in the series of cases that began with D.P.U. 89-300. See D.P.U. 86-33-G at 477-478 (1989).

A review of Verizon's detailed contribution margin analyses indicates that basic residential services contribute far less to the recovery of joint and common costs than virtually all other services (see Exh. VZ-5, Atts. A, B). Specifically, the analyses demonstrate that the relative contribution from the residential dial-tone line rate is significantly below that of almost all other Verizon residential services, even compared to different measures of incremental costs from Verizon's Marginal Cost Study VI (1994) and the 1997 TELRIC study developed in the Consolidated Arbitrations (see id.).[53] We agree with Verizon that this level of contribution is "neither fair nor economically efficient and is not a result that would prevail in an unregulated competitive market" (VZ Brief at 23).

The Attorney General's assertion that Verizon's measures of incremental cost are inaccurate and overstate the true incremental cost of providing basic residential service is

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53 Verizon demonstrates that the present dial-tone line rate contains a 21.82 percent margin above marginal costs. The -18.85 margin relative to TELRIC cost is due to the loading of 25 percent for joint and common costs already included in the TELRIC rates. If joint and common costs are removed from TELRIC, the present dial-tone line rate has an 8.76 percent margin above TELRIC (see Exh. VZ-5, Att. B).

based on the Attorney General's position that the local loop is a shared facility, the cost of which should be allocated to the various services that use the loop (Tr. 2, at 223). The Attorney General's assertion that the contribution margin for the residential dial-tone line rate may be higher than shown in Verizon's contribution margin analyses is premised on this "shared cost" assumption, which results in a lower underlying marginal cost for providing residential service. However, the Attorney General's assertion is inconsistent with the principles of cost causation, under which responsibility for the costs incurred to provide the loop is assigned to the customer who caused that cost to be incurred.

We agree with Verizon and AT&T that the local loop is demanded in its own right, and that the cost of the loop is incurred and easily identified when it is provisioned – irrespective of subsequent usage (Exhs. VZ-6, at 6-21; ATT-2, at 7-8).[54] This is the same conclusion the Department reached in the late 1980's when it reviewed Verizon's marginal cost study (see D.P.U. 86-33-G at 455 ("Access is customer-related because it is the demand for lines connecting the customer's premises with the central office that causes these costs to be incurred")), and the record in this case does not cause us to revise that finding in this context.

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54 The assertion of Verizon's witness, Dr. Taylor, in an October 4, 2000 proceeding before the New Mexico Public Regulatory Commission that the loop is a shared cost – which the Attorney General asserts contradicts Verizon's position in the instant proceeding – specifically addresses the recovery of shared costs between voice access to the network and the high-frequency data UNE, which are truly joint products in the sense that they are only available in a fixed proportion where the individual incremental costs of voice access and data access are not defined (see Exhs. VZ-7, at 19-20; AG-6). In the same proceeding before the New Mexico Commission, Dr. Taylor clearly stated that, with respect to basic exchange service and other telephone services, cost causation dictates that the loop cost should be borne entirely by basic exchange service (Exh. VZ-7, at 75-78). Therefore, we determine that Dr. Taylor's assertions in the New Mexico proceeding do not contradict Verizon's position in this proceeding.

Therefore, we determine that the entire cost of the loop is properly identified on a cost-causative basis with the provision of access, whether as an unbundled loop or bundled with local usage as basic residential service. We further determine that this incremental cost is not an insignificant amount because, in a network industry, the cost of access should be calculated prior to the services that rely on that access. When the cost of the loop is identified entirely with the dial-tone line rate (as in Exh. VZ-5, Att. B), the dial-tone line rate contains significantly less contribution to joint and common costs than usage-based services.

The question then is what measure of incremental cost is appropriate for ensuring that rates are just and reasonable and promote efficient competitive entry? For the reasons discussed below, we conclude that TELRIC is the appropriate cost standard to meet these goals. AT&T argues that, because Verizon charges competitors more for the network elements necessary to provide a competing service than the marginal cost it incurs to provide the service itself, UNE-based competitors that require inputs from Verizon will not be able to compete unless Verizon's basic residential rates equal or exceed the sum of the TELRIC-based UNE rates of the UNEs that comprise basic residential service plus Verizon's retailing costs. Whereas Verizon may argue that its prices should be based on marginal cost or TSLRIC data, approval of such prices might enable Verizon to engage in an anticompetitive "price squeeze" by decreasing its retail rates until the margin between its price for basic residential service and the cost of the underlying UNEs is reduced to the point where UNE-based residential service competitors cannot efficiently compete with Verizon.[55]

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[55] While the Department's grant of upward pricing flexibility for Verizon's retail business services that are contestable on a UNE basis required a showing of sufficient (continued...)

Another factor weighing in favor of using TELRIC as the appropriate cost standard is that TELRIC already includes an allocation of joint and common costs. The allocation of joint and common costs in the TELRIC model is a fixed percentage, and thus is not consistent with Ramsey pricing principles. But, with the difficulties associated with setting Ramsey-based prices discussed above, it is an acceptable alternative to rely on a fixed percentage allocation, which at least moves in the direction of a more efficient allocation of joint and common costs. In effect, the Department concludes that our standard for judging the reasonableness of regulated rates for telecommunications services – whether wholesale or retail – should be harmonized by using the same cost standards (see Section IV.D, below, for a discussion of re-pricing of certain wholesale services), and that this "bottom-up" approach is more compatible with determining individual rate elements, rather than the "top-down" cost analyses used in cost-of-service or price cap regulation, which are relevant only to aggregate determinations of revenue requirements.

While the Department concurs with AT&T that ideally, Verizon's basic residential rates should be set at least equal to the cost it imposes on its competitors to provide a competing service, that is, the UNE rates underlying the competing services (averaged across the state for UNE prices that differentiate by zone), plus a mark-up equal to the resale discount percentage, requiring this change would necessitate such a large increase in the price of basic residential service that it would be incompatible with the important Department goal of rate

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[55](...continued)
competition, that pricing flexibility was also predicated on the establishment of a price floor "equal to the density zone-specific UNE rates underlying the service plus a mark-up equal to the resale discount percentage." Phase I Order at 92.

continuity. For example, using the new UNE rates under review in the Department's D.T.E. 01-20 proceeding, this approach would require an increase of $6.58 over Verizon's current dial-tone line charge of $9.91 (an increase of over 66 percent), which, as noted above, is the least elastic rate element for basic residential services.[56] The Department therefore faces the challenge of balancing its interest in encouraging efficient competitive entry with its commitments to rate continuity and continuation of universal service. While in the past, the Department has embarked upon a multi-year, transitional process to achieve large increases in basic residential service rates,[57] by adopting the significantly smaller, one-time increase discussed below, we conclude that a multi-year approach is unnecessary.

In balancing our competing goals, we conclude that a one-time increase of $2.44 in Verizon's dial-tone line charge represents a substantial movement in the direction of aligning local telephone rates with their underlying costs without burdening consumers with rate shock or potentially affecting the overall rate of telephone subscription in Massachusetts.[58]

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56 This estimated increase is calculated using a 24.99 percent retail markup and $15.26 loop and $2.73 port UNE rates. ($15.26 + $2.73) (1.2499) = $22.49. The current rate for Verizon's One Party Measured Residential Service ("1MR") is $15.91 ($9.91 dial-tone line charge + $6.00 Federal subscriber line charge). $22.49 - $15.91 = $6.58. See UNE Rates Proceeding, D.T.E. 01-20 Part A-A, Verizon Compliance Filing, Tab 2A (February 13, 2003); Tariff M.D.T.E. No. 10, Part M, Section 1, Page 14. We use 1MR in this analysis because it is the most basic and inexpensive of Verizon's basic residential services, and this service will show the largest change with an increase in the dial-tone line charge.

57 From 1990 to 1994, the Department gradually increased residential dial-tone line rates from $1.19 to $9.91 before instituting the rate freeze in 1994 (see VZ Brief at 16).

58 As discussed fully below in Section IV.D.3, an elimination of the separate charge for Verizon's Touch Tone service will bring the increase in the dial-tone line charge to less that $2.00 for the vast majority of Verizon's residential customers.

This increase is close to the average increase of $2.18 per year implemented during the four years of Department rate re-balancing in the early 1990's,[59] which record evidence shows to have had virtually no impact on the residential telephone subscriber penetration rate.[60] Therefore, we conclude that this one-time $2.44 increase in basic residential rates will not harm the Department's universal service goals. Moreover, the very low elasticity of demand for dial-tone service confirms that small increases in that charge will have a negligible effect on residential subscriber penetration, if any. In addition, this increase is also roughly comparable to recent increases in basic residential rates in several other states,[61] and to the overall increase in the Federal subscriber line charge since 2000.[62] We have chosen $2.44 per line for this increase in order to make it proportionate to changes we are making to rates for

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59 In the last rate re-balancing effort undertaken in the early 1990's, the Department ordered the following increases in Verizon's dial-tone line charge: $3.31 in 1990, $1.12 in 1991, $1.80 in 1993, and $2.49 in 1994. D.P.U. 89-300 (1990); D.P.U. 91-30 (1991); D.P.U. 92-100 (1992); D.P.U. 93-125 (1994).

60 Despite a total increase in the dial-tone line rate of over 730 percent between 1990 and 1994 in Massachusetts, the residential subscriber penetration rate barely declined, from 96.6 percent in 1990 to 96.5 percent in 1994, and, as of November 2001, the residential penetration rate in Massachusetts stood at 95.9 percent (Exhs. VZ-2, at 10; AG-2, at 12).

61 The Maine Public Utilities Commission approved a $1.78 increase in Verizon's basic monthly per line rate in May 2001. <u>Investigation into Verizon-Maine's Alternative Form of Regulation</u>, MPUC Case No. 99-851, Part 2 (May 9, 2001). The New York Public Service Commission authorized a two-year Verizon Incentive Plan (with a third year for the Service Quality Plan) which permits increases in the Basic Service charges up to $1.85 in the first year and $0.65 in the second year for the customer's first line. <u>Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework</u>, NYPSC Case No. 00-C-1945 (February 27, 2002). According to the NYPSC, these increases would count against a 3 percent cap on overall revenue growth for Verizon. <u>Id.</u>

62 The Federal subscriber line charge has increased from $4.35 in July 2000 to $6.00 in July 2002. <u>See</u> 47 C.F.R. § 69.152(d).

services that are currently priced at inefficiently high levels (see Section IV.D.3, below). Ideally, all wholesale services would be priced at UNE levels, and all retail services would be priced to cover the imputed UNE costs plus retailing costs. But, as discussed above, such a move would violate our goal of rate continuity. Therefore, we have concluded that a partial movement toward a more efficient rate structure is appropriate, and it is fair to keep the increases in proportion to the decreases.

While an increase of $2.44 to Verizon's dial-tone line charge falls short of moving the price of 1MR[63] to its ideal level (i.e., at least equal to the sum of the underlying UNE rates plus a retail markup), it is important to note that 1MR lines constitute a very small subset of total Verizon residential lines.[64] The vast majority of Verizon basic residential services customers subscribe to various bundled packages that combine usage with basic dial-tone service.[65] An increase of $2.44 in Verizon's dial-tone line charge ensures that the retail price of these bundled basic service packages would be priced above the sum of the underlying UNE rates plus a retail markup, thereby encouraging further competitive entry for these services. For example, One Party Unlimited Local Residential Service ("1FR"), Verizon's most popular

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63 The current rate for Verizon's 1MR service is $15.91 ($9.91 dial-tone line charge + $6.00 Federal subscriber line charge). See Tariff M.D.T.E. No. 10, Part M, Section 1, Page 14.

64 Verizon's 1MR lines constitute approximately 4.3 percent of total Verizon residential lines. See Verizon Massachusetts Sixth Annual Massachusetts Price Cap Compliance Filing, Section C at 27-28 (filed October 2, 2000).

65 Bundled services that include usage with dial-tone access account for approximately 95.7 percent of total Verizon residential lines. Id.

bundled basic residential package is currently priced at $22.85.[66] An increase of $2.44 in the dial-tone line charge would raise the price of 1FR to $25.29, which is above the cost that Verizon's competitors must incur to provide a competing service.[67]

Although the possibility of a "price squeeze" would continue to exist for CLECs that wish to serve the small class of customers who subscribe to 1MR, several reasons mitigate this concern. First, 1MR subscribers who demand vertical services, such as Call Waiting and Caller ID, can be excluded from the class of customers for whom competitors encounter a "price squeeze" because the relatively high margin built into vertical services ensures that the total rate paid by the customer at least meets the cost of serving that customer. Moreover, the emergence of residential service packages that bundle local and toll calling with long-distance calling (such as MCI's Neighborhood Plan, Sprint's Common Sense, and Verizon's own Veriations Plan) reduce the importance of the profitability of dial-tone access alone in encouraging and sustaining competition. We concur with Verizon's witness, Dr. Taylor, on the following:

> [S]ometimes we ask the question, can a CLEC make money in residential service, for example? And for that, what matters is the full panoply of services that a CLEC or ILEC can expect to provide when it attracts a customer. So for that it makes sense to include the revenues and the costs from vertical services in the calculation.

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66 This current rate for Verizon's 1FR service is calculated as follows: $9.91 (dial-tone line charge) + $6.00 (Federal subscriber line charge) + $6.94 (unlimited local usage). <u>See</u> Tariff M.D.T.E. No. 10, Part M, Section 1, Page 14.

67 This cost is calculated using a 24.99 percent retail markup and the following UNE rates: $15.26 (loop) + $2.73 (port) + $0.9864 (switching [assuming a typical 600 minutes of use per month]) (1.2499) = $23.72. <u>See</u> <u>UNE Rates Proceeding</u>, D.T.E. 01-20 Part A-A, Verizon Compliance Filing, Tab 2A (February 13, 2003).

(Tr. 1, at 16). Therefore, with the $2.44 one-time increase in Verizon's dial-tone line charge, we determine that competitors can profitably enter and serve the residential telephone market in Massachusetts, without burdening consumers with a large increase, or multiple, multi-year increases in service rates. Because we conclude that a $2.44 increase in Verizon's dial-tone line charge reasonably balances our goals in promoting competition and in ensuring rate continuity and universal service, we do not find that any further upward pricing flexibility for Verizon is warranted at this time. Verizon may seek further upward pricing flexibility for its basic residential services when it can demonstrate the presence of sufficient competition for these services, as it has with its retail business services.[68]

In addition, Verizon sought and was granted in Phase I the ability to deaverage business prices by density zone, but Verizon did not seek that flexibility for residential prices. While retail prices that reflect geographic cost differences would enhance efficiency, particularly because UNE loop rates are geographically deaveraged, we do not believe deaveraging of basic residential rates would be appropriate at this time, nor does the record support such a change. The Department may, in a future docket, consider adoption of a universal service funding mechanism to reduce the arbitrage opportunities and the price squeeze problems presented by the interaction of deaveraged wholesale prices and averaged retail prices.

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68 We note that the economic conditions that the Department relied upon in granting pricing flexibility for Verizon's business services may be present for residential services. If that is the case, it may be appropriate for Verizon to seek classification of residential services as sufficiently competitive in order to better match regulatory oversight to market conditions.

e. Affordability

We determine that pricing basic residential services in this manner continues the long-standing Department objective of a transition to more competitive, economically efficient prices for basic residential services, while also minimizing rate shock to consumers. Indeed, the increase of $2.44 (under $2.00 to Verizon's Touch Tone customers) still constitutes about one third of the increase necessary to fully resolve the disparity between basic residential retail rates and the underlying UNE costs. Moreover, while the prices of Verizon's basic residential services have fallen in real terms since 1994, Massachusetts incomes have increased in real terms, and the cost of basic residential service as a percentage of income has declined considerably from 0.76 percent in 1994 to 0.52 percent in 2002 (Exhs. ATT-6; VZ-3, at 15). Thus, we conclude that Verizon's basic residential service rates can be increased somewhat without compromising the affordability of basic residential service. Finally, as discussed further in Section IV.D.3, below, an increase in the LifeLine credit offers targeted assistance to those least able to afford telephone service, ensuring that the cost of basic telephone service remains unchanged for those customers who receive assistance for this service.

C. Non-Basic Residential Services[69]

1. Introduction

As part of our Phase I investigation, the Department tentatively concluded that Verizon's non-basic residential services should continue to be regulated differently from basic services. Phase I Order at 104. The Department noted that since the Department's first rate

69 Verizon's non-basic retail residential services include such offerings as Directory Listing Service, Busy Line Verification and Busy Line Interrupt, Ringmate Ring ID Service, and Integrated Services Digital Network ("ISDN") (Exh. VZ-1, at Tab A, Att. B).

re-balancing order – D.P.U. 89-300 (1990) – non-basic services have been considered to be premium services, and the Department has allowed Verizon to price its non-basic services based on market conditions and revenue-maximization. Id. Consequently, in the Phase I Order, the Department tentatively concluded that, going forward, Verizon should be accorded at least the same level of flexibility as it currently has for its non-basic residential services. Id.

2. Positions of the Parties

a. Verizon

Verizon argues that the Department should grant pricing flexibility for Verizon's non-basic residential services consistent with the Department's findings in D.P.U. 89-300, at 146 (1990) and D.P.U. 92-100, at 62 (1992) regarding pricing flexibility for auxiliary and discretionary services (Exh. VZ-2, at 7; Tr. 1, at 18-19). Verizon further argues that because the Department granted pricing flexibility for Verizon's business services in Phase I of this proceeding, pricing flexibility for non-basic residential services is necessary in order to have symmetric competition among all carriers (Tr. 1, at 18-19). In addition, Verizon asserts that new services (which could include bundles of existing services) should be subject to the same pricing flexibility (id. at 20). With new services, argues Verizon, there is no "incumbent" provider per se, and no competitive harm (such as driving a competitor from the market) could result from allowing pricing flexibility for those services (id. at 19).

No other party addressed Verizon's non-basic residential services or new services.

3. Analysis and Findings

We agree with Verizon that a continuation of pricing flexibility for Verizon's non-basic residential services is warranted. No party has provided any record evidence to support a departure from our current regulatory treatment of non-basic residential services, which has resulted in just and reasonable rates for these services, and we find that our telecommunications policy goals of continuity and simplicity would be best served by this approach. This pricing flexibility is consistent with our treatment of retail business services, in that these rates will continue to be set based on market forces. With regard to new services, we agree that in order to encourage innovation, pricing flexibility for new services is also warranted, subject to the applicable price floor rules.

D. Re-Pricing Issues

1. Introduction

In the Phase I Order, the Department ordered Verizon to re-price the following services: switched access, PAL, PASL, collocation, special construction, and residential Touch Tone.[70] Phase I Order at 61-64, 94-95, 105. The Department also required Verizon to calculate the new residential dial-tone line rate that would result from revenue-neutral reductions in access pricing. Id. at 63, 105. These directives were made in order to create a consistent regulatory framework and pricing standard for all wholesale services and to improve the efficiency of pricing.

2. Positions of the Parties

a. Verizon

Verizon proposes to increase its residential dial-tone line rate by $2.44 per month (from $9.91 to $12.35 per month) in order to offset the revenue loss resulting from the re-

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70 Touch Tone is a service provided to Verizon residential customers that do not use a rotary dial phone. Only 8.7 percent of Verizon's Massachusetts customers continue to use rotary dial or "pulse" phones (Exh. AG-VZ 2-8).

pricing ordered in the Phase I Order for Verizon's switched access, Touch Tone, PAL, PASL, and collocation services (Exh. VZ-2, at 14).[71] Verizon states that this rate increase will affect 2,745,851 residential customers in Massachusetts, excluding the 163,605 LifeLine customers (Exh. AG-VZ 1-4).[72] Verizon argues that no party has questioned Verizon's calculation of the Department-ordered offsets (VZ Brief at 5). Verizon argues that it has calculated its revenue losses based upon historical data, which is consistent with Department requirements (VZ Reply Brief at 4). Verizon further argues that the revenue-neutral approach reflects the continuation of the Department's rate re-balancing process initiated in D.P.U. 89-300 (1990), and is not associated strictly with ROR regulation (id. at 9).

Verizon argues that, in order to be consistent with the Department's rate re-balancing policy established in the late 1980s, and also because residential dial-tone is the most inelastic service of its offerings, "if the Department determines that Switched Access charges should be lowered, the offset should be made by an increase in . . . the Residence Dial Tone Line rate" (Exh. VZ-5, at 4).[73] Verizon argues that, contrary to the Attorney General's characterization,

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71 The $2.44 per month increase to the residential dial-tone line rate would affect the minority of Verizon's customers that do not currently have Touch Tone service (Tr. 2, at 109-110). For Verizon's customers that do currently have Touch Tone service, the increase would be $1.95 per month (id. at 110).

72 Verizon's LifeLine program provides statewide assistance to eligible Massachusetts customers in the form of a discount in the monthly rates for one exchange service line. In order to receive this discount, customers must be participating in an eligible state or Federal assistance program, such as Supplemental Security Income, Food Stamp Benefits, or Fuel Assistance, and must meet eligibility guidelines on file with the relevant government agency. The rate reduction appears on the customer's monthly bill and is determined as a specified amount of the state or Federal assistance received by the customer (Exh. AG-VZ 5-4, Att. 1).

73 As discussed above in Section III.C, Verizon did not include in its Phase I Compliance

(continued...)

the revenue-neutral filing for the reduction in switched access charges will not result in additional revenue for Verizon (id. at 1). Verizon argues that the "predominant" portion of the offset which accounts for switched access re-pricing to interstate levels is approximately \$1.98 per month (see Exh. VZ-2, Att. A, Tab B (revised 8/28/02), Workpaper 1).[74]

In addition, contrary to the Attorney General's argument that the approval of Verizon's proposal depends on the effect of the switched access rate changes on retail toll customers, Verizon argues that the Department has consistently re-balanced rates on a revenue neutral basis by gauging the effect on Verizon, not on its end users (VZ Reply Brief at 5). Further, Verizon argues that recovery of its revenue losses from residential customers is not discriminatory as the Attorney General contends (id. at 9). According to Verizon, its proposal to recover its revenue losses is based on Ramsey-efficient pricing principles (id.). Verizon argues that the Attorney General's witness, Dr. Gabel, agrees that Ramsey pricing principles would produce rates that place greater responsibility for cost recovery on services having the lowest elasticity of demand (id. at 7). Verizon argues that there is general agreement, with the exception of Dr. Gabel, that demand for residence customer access (i.e., dial tone) is highly inelastic, therefore, recovery of lost revenue from the residence class is reasonable (id.).

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[73](...continued)
Filing any calculations relating to reductions in Verizon's special access rates. In response to Department questioning, Verizon states that reducing special access rates to UNE levels would necessitate an additional \$0.01 per month increase to the residential dial-tone line rate (using current demand assumptions), and a possible increase of up to \$4.00 per month or more if all interstate special access lines were reduced to UNE pricing levels (Supp. RR-DTE-1; Exh. DTE-VZ 3-4; Tr. 2, at 112-113).

[74] The amount of Verizon's proposed monthly switched access offset is calculated as follows: (line 22a, Switched Access Rate reduction w/o [demand] stimulation) / (line 23, Access Lines Incurring Offset) / (12 months) or (-\$61,225,920) / (2,582,246) / (12) = \$1.98 (see Exh. VZ-2, Att. A, Tab B (revised 8/28/02), Workpaper 1).

In addition, Verizon states that in the Phase I Order, the Department ordered Verizon to file a proposal to re-price PAL, PASL, and collocation services in a UNE-based manner (Exh. DTE-VZ 2-1). According to Verizon, its proposal includes an increase to the residential dial-tone line rate to offset the revenue effect of re-pricing these services, which is consistent with the revenue-neutral approach adopted by the Department for other reductions in wholesale rates (Exh. VZ-1, at 7). Verizon argues that the amount of the total offset required by the re-pricing of collocation services would be $15,925 per annum, and that the total offset amount to the residential dial-tone line rate would be reduced by the additional revenue generated by the re-pricing of PAL and PASL of approximately $345,000 (id. at 7, and Tab B, Att. 1, Workpaper1).

Further, Verizon proposes to eliminate the separate charge for Touch Tone service (id. at Tab B, Att. 1, Workpaper 1). Elimination of this separate charge, argues Verizon, will result in an additional increase of $0.47 per month to 238,879 non-Touch Tone subscribers (Exh. AG-VZ 1-4). Verizon argues that, consistent with Department precedent, because 91.3 percent of Verizon's residential customers subscribe to Touch Tone service, the service should be considered ubiquitous, and, as such, should be absorbed into the basic residential service rate (Exh. AG-VZ 2-8). Contrary to the Attorney General's claim that Verizon's Touch Tone proposal would be discriminatory, Verizon argues that it is reasonable and appropriate to consider this service as an integral element of basic service (VZ Reply Brief at 13).

Finally, to compensate for the proposed increase to the residential dial-tone line rate resulting from proposed offsets, Verizon proposes to increase the LifeLine credit equal to the proposed increase in dial-tone rates to maintain existing rate levels for LifeLine customers and that any future increase in the Dial Tone Line rate will result in an equal increase in the LifeLine credit (Exh. VZ-2, at 14). In this way, Verizon argues that LifeLine customers will be unaffected by any increase in the rate for basic dial-tone service (id.). Similarly, Verizon proposes that any rate increases to its service connection charges to install a network access line will "automatically result in an increase in the Link[-U]p America discount" (Tr. 1, at 51).[75]

b. Attorney General

The Attorney General argues that the Department should reject Verizon's proposal to increase residential dial-tone line rates to recover estimated revenues from reductions for switched access and other services (AG Brief at 9). The Attorney General argues that because Verizon bases its proposal on estimated – not actual – lost revenue, Verizon may reap a windfall if its actual revenue losses are not as much as its estimated losses (id. at 11). A more fair approach, argues the Attorney General, would be for Verizon to recover only its actual lost revenue and conduct an earnings review to ensure that the increases are necessary for Verizon to obtain reasonable compensation (id.).

Further, the Attorney General argues that there is no record evidence that shows that interexchange carriers will pass along their savings from reduced intrastate access charges to Verizon's customers, such that increases in residential dial-tone may not be revenue-neutral to the customer (id. at 11-12). In addition, the Attorney General argues that lost revenue from reductions in PAL, PASL, collocation, and special access rates would come from both

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[75] Verizon's Link-Up America program is a network connection assistance program that provides reduced connection charges for eligible households, consistent with the LifeLine eligibility criteria (Exh. AG-VZ 5-5; see Tariff M.D.T.E. No. 10, sec. 1.7.1 - 1.7.2).

business and residential customers, while residential customers are unjustly and discriminatorily being asked to compensate for all of the lost revenues (id. at 12). Moreover, argues the Attorney General, the concept of revenue-neutrality is used under rate of return regulation, which, according to the Attorney General, the Department has concluded is inappropriate for Verizon's residential services (id.).

In addition, the Attorney General argues that charging customers for Touch Tone service when they have not requested it would be unfair (id. at 13). The Attorney General argues that Verizon has presented no evidence to support its proposal to change Touch Tone from an optional to a mandatory service, and that the monthly dial-tone line increase from Verizon's re-pricing would unfairly fall on Verizon's residential customers who have not requested Touch Tone service (id. at 13-14).

c. AT&T

AT&T argues that in order to enable competition, the Department must establish efficient prices that move away from traditional residual pricing methods (Tr. 3, at 292). AT&T states that in the Phase I Order, the Department found that the reduction in switched and special access rates must be made up by increasing residential dial-tone rates (Exh. ATT-1, at 26 n.11). However, AT&T argues that the Department's determination that residential dial-tone rates must increase as a result of the reductions in access pricing is inconsistent with the regulatory approach the Department seeks to implement to transition to a competitive residential marketplace (id.). AT&T argues that determining efficient input prices is independent from establishing subsidy-free residential rates; and that "[o]nly in the by-gone era of ratemaking in which policymakers sought 'to keep the Company whole' would such logic apply" (id. at 27 n.11; see AT&T Reply Brief at 10). AT&T argues that to link together a reduction of input prices with an increase in residential rates in order to achieve efficient pricing levels is "the wrong logic for getting to what may be ultimately the right conclusion" (Tr. 3, at 292). AT&T argues that to do so "would be, in a sense, unjust and unreasonable" and urges the Department "to not perpetuate the cost-of-service, 'make-whole' logic of linking these two sets of prices" (id. at 293; see Exh. ATT-1, at 27 n.11).

3. Analysis and Findings

Although the Department ordered the re-pricing of Verizon's switched access, PAL, PASL, collocation, special construction, and residential Touch Tone services as part of Phase I of this proceeding (see Phase I Order at 61-64, 94-95, 105), and discussed whether Verizon was in compliance with our directives in the Track A section of this Order, the focus of the Department and the parties in our Track B proceeding has been the effect that this re-pricing will have on the rates for Verizon's residential services. Verizon argues that, consistent with the Department's tentative conclusions in the Phase I Order, all of the revenue losses resulting from the Department-ordered re-pricing should be made up by revenue-neutral increases to Verizon's residential dial-tone line charge.

As an initial matter, the Department agrees with Verizon that it is appropriate to eliminate the separate charge for residential Touch Tone service and to price switched access at interstate levels. In the Department's first rate re-balancing Order, we stated:

> [to] the extent that subscription to a service like touch tone (or any other supplemental service) becomes so widespread as to be considered basic service to most customers, there may be no real difference between maintaining the rates above cost for that supplemental service, or reducing the rate for the supplemental service and increasing the basic monthly charge. Indeed, if the cost for a universally accepted supplemental service is very low, at some point it may be

> appropriate to eliminate the separate charge altogether and make the service part of basic exchange service.

D.P.U. 89-300, at 146-147 (1990). We agree with Verizon that 91.3 percent of Verizon's residential customers subscribing to Touch Tone service constitutes, in effect, ubiquitous subscription to this service and that the separate charge should be eliminated.[76] Because the cost for this "universally accepted supplemental service" is low, we will eliminate the separate charge and make Touch Tone part of Verizon's basic residential service, consistent with our related holdings in D.P.U. 89-300 (1990) and D.T.E. 99-102 (2000).[77] It is also appropriate to lower switched access rates to interstate levels, as we concluded in the Phase I Order. Otherwise, it could cost customers more to make calls across the state than it does to make calls across the country.

Turning to a discussion of the Department-ordered re-pricing of certain wholesale services, including access services, we conclude that the concept of pricing for basic residential services we have adopted in this proceeding, and the concept of "revenue-neutral price changes" between wholesale and retail services, are not incompatible because we are only moving partially towards efficient rates. As discussed above in Section IV.B.3, the pricing structure we adopt in this proceeding for Verizon's basic residential services is consistent with the goals established in the Department's IntraLATA Competition Order and

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[76] Similarly, as part of its review of Verizon's fifth price cap filing, the Department allowed Verizon to eliminate the separate charge for Touch Tone for Verizon's business customers. Verizon, D.T.E. 99-102, at 16-18 (2000).

[77] As additional support for the inclusion of Touch Tone into basic residential service, the Department can look to the FCC's designation of Dual Tone Multi-Frequency signaling (i.e., Touch Tone) as a "core" service to be supported by universal service. See In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157, at ¶ 61 (rel. May 8, 1997).

continues to move all rates towards their economically efficient levels. If we were moving rates to the ideal level where all wholesale services are priced at UNE levels and all retail services are priced to recover UNE and retailing costs, then it would not be appropriate to link revenue losses on one side with revenue increases on the other, as AT&T suggests. However, for the reasons discussed above, we are not willing to move fully to economically ideal rates at this time. Therefore, it is appropriate and fair that movement on one side of the ledger be matched with symmetrical movement on the other side. For example, it would not be fair to increase residential retail rates by an amount that produces more revenue than Verizon is losing from reductions towards efficient rates in other areas, and vice versa.

We also agree with Verizon that an increase in the LifeLine credit is necessary to maintain existing rate levels for Verizon's customers receiving assistance through the LifeLine program. Therefore, we order Verizon to increase its LifeLine credit commensurate with the increase adopted in this proceeding for Verizon's basic residential service. In addition, consistent with Verizon's proposed plan, we find that any future increases to Verizon's monthly rates for one- or two-party Unlimited Basic Exchange Service, Low Use and Standard Residence Measured Service 4E (Four Element), and Residence Measured, Circle Calling, Suburban, Metropolitan, Bay State East, and Call Around 413 services shall be met by an increase to its LifeLine credit; and any future increases to Verizon's Element 1 or Element 2 service connection charges shall be met by an equal increase to its Link-Up America discount.

E. Quality of Service Plan

1. Introduction

In the Price Cap Order, the Department adopted a price cap form of regulation for Verizon that included a Service Quality Plan designed to evaluate the overall level of service provided by Verizon to its retail customers. D.P.U. 94-50, at 229. Under the Service Quality Plan established in the Price Cap Order, any increase in rates would be subject to Verizon meeting specified levels of service quality for its retail customers. The Service Quality Plan focused on twelve key measures in the three service categories of installation, maintenance, and service response. Id. at 77-78 (see also Exh. DTE-VZ 1-3). Depending on the level of performance, points were assigned to each individual measure, and combined to produce a monthly Service Quality Index ("SQI") score. Id. at 78. The SQI operated by requiring that Verizon maintain or achieve a Department-mandated 33-point level of service quality. Id. at 236. If the total SQI score for a given month was less than the required 33 points, or if three or more of the twelve individual measures used to calculate the SQI scored zero points, the Department assessed Verizon a financial penalty that increased the productivity offset of one twelfth of one percent for each month in which the SQI criteria was not met. Id. at 238. By increasing the productivity offset, the retail revenues received by Verizon were reduced by the penalty amount (Exh. DTE-VZ 3-7).

In the Phase I Order at 105, the Department directed Verizon to include as part of its compliance filing a proposed Service Quality Plan with associated penalties to succeed the formula adopted in the Price Cap Order.

2. Positions of the Parties

a. Verizon

In the Phase II (Track B) evidentiary proceeding, Verizon argues that the Massachusetts telecommunications market is sufficiently competitive to discipline Verizon to provide high quality service to its retail customers, and, therefore, there is no need for the Department to impose any retail service standards and penalties (Exh. VZ-4, at 1-2, 18-19; Tr. 2, at 138; VZ Brief at 19-20).[78] If the Department finds that a service quality plan is necessary, Verizon argues that retention of the Service Quality Plan adopted in the Price Cap Order (as proposed in Verizon's Phase I Compliance Filing, governing both Verizon's retail residential and business services) will ensure that if Verizon's retail service quality falls below the Department threshold, Verizon will be subject to a penalty (Exh. VZ-4, at 2-4).

Verizon argues that in lieu of a penalty payment based on a productivity offset of one twelfth of one percent (as required in the Price Cap Order), Verizon will forfeit one twelfth of one percent of annual retail revenue for every month that either the overall performance level was less than the existing 33-point level, or if three or more of the twelve individual service items that comprise the SQI fell below a specific threshold on a statewide basis in a given month (Exh. VZ-1, at 8-9, Tab A at 5). Verizon proposes that at the conclusion of each calendar year, it would incur a financial penalty if it does not meet the service quality requirements in any of the preceding twelve months (Exh. VZ-2, Att. 2, at 5). The penalty

[78] Verizon asserts that it is currently the only telecommunications carrier in Massachusetts subject to Department-imposed retail service quality standards (VZ Brief at 20). Verizon further asserts that the Department's application of service quality requirements to one carrier only is discriminatory and could distort the competitive process (VZ Reply Brief at 23).

payment would be made as a one-time credit to all residence and business lines on an annual basis (Exh. VZ-1, at 8-9, Tab A at 5).[79] Verizon states that the proposed penalty provision is intended to replicate the penalty mechanism established in the Price Cap Order, adjusted to reflect the fact that Verizon's proposed alternative regulation plan does not include a price cap formula (Exh. DTE-VZ 1-9).

Finally, Verizon argues that the Attorney General's suggestion to open a new Department investigation to examine Verizon's service quality measurements and thresholds is untimely and should be rejected (VZ Reply Brief at 24). Verizon argues that the Attorney General had the opportunity within the instant proceeding to present alternatives to Verizon's proposed service quality plan, and the Attorney General chose not to do so (id.). Moreover, Verizon argues that although its current service quality standards were established in 1995, the fundamental needs and desires of customers have not changed since that time; therefore, changes to the current plan are unnecessary (id. at 24-25).

b. Attorney General

The Attorney General argues that the Department should reject Verizon's proposal to eliminate service quality requirements, and should maintain an effective retail service quality standards and reporting system (Exhs. AG-1, at 5; DTE-AG 1-1; AG Brief at 30-32). The Attorney General argues that the Department cannot rely on market forces alone to correct Verizon's incentive to cut service quality where there is no effective competition, and that the Department should not hold Verizon to lower retail performance standards than the

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79 Verizon asserts that it would petition the Department to have monthly service quality results modified during periods of emergency, catastrophe, natural disaster, severe storms, or other events beyond Verizon's control (Exh. VZ -4, Att. 2, at 6).

Department requires of electric or natural gas distribution companies (AG Reply Brief at 15-16). The Attorney General further argues that the vast majority of telephone customers depend on Verizon to establish the service quality level, either directly as a provider of retail services, or indirectly through CLECs' use of UNE-P or resale (Exh. DTE-AG 1-1). In support of his position, the Attorney General relies upon a recent FCC study that indicates at least 93% of all end users depend on Verizon to set the level of service quality (id. at Att. A). If the Department does not continue the productivity factor in a price cap formula, the Attorney General agrees that Verizon should make one-time payments to its retail customers for any substandard retail service (AG Brief at 31).

However, the Attorney General argues that the current service quality plan containing twelve service quality categories and mandated service thresholds is outdated and does not reflect changing markets or Verizon's ability to provide increasingly higher quality service (id. at 32-33). Therefore, the Attorney General argues that the Department should undertake a further investigation to analyze ten years of Verizon's consumer complaint and service quality data, as well as to review the different types of service quality items and thresholds used in other jurisdictions (id. at 33-34; see Exh. DTE-VZ 1-8). As a result of this further investigation, the Attorney General argues that Verizon's service quality standards should be revised and service thresholds should be raised (AG Brief at 34-35).

3. Analysis and Findings

As an initial matter, we disagree with Verizon's position that a continuation of the Department's monitoring of Verizon's retail service quality is unnecessary and discriminatory. In the Price Cap Order, the Department concluded that because price cap regulation introduces a financial incentive for the regulated firm to reduce costs, a well-designed price cap plan must also include some form of protection against reduction in service quality; otherwise, the regulated entity could increase its profits by reducing service quality. Price Cap Order at 235-236. The Department's adoption of a price cap form of regulation for Verizon therefore included a service quality plan designed to evaluate the overall level of service provided by Verizon to its retail customers.

Although Verizon is no longer subject to price cap regulation, competition for some customers may introduce a financial incentive for the regulated entity to reduce costs by reducing service quality to other customers, so we conclude that there should continue to be some form of protection against a reduction in service quality. Therefore, given that Verizon's residential retail services will be regulated under the alternative form of regulation we have established in this proceeding, the Department finds it reasonable and appropriate to continue a retail service quality plan and penalty mechanism for these services. While the decisions of other state utility commissions are not determinative, our approach is consistent with the actions of the California, Connecticut, Maine, New York, and Pennsylvania utility regulatory commissions, which have continued to require service quality plans for Verizon under alternative regulatory regimes (see Exh. DTE-VZ 1-8).

We also determine that the imposition of retail service quality monitoring on Verizon alone is not discriminatory. Although we have not conducted a full analysis of the extent of competition for Verizon's residential services in Phase II of this proceeding (as we did with Verizon's business services in Phase I), Verizon continues to be classified as a dominant provider of telecommunications services in Massachusetts for both business and residential services. Since 1985, the Department has differentiated in the application of regulatory requirements to different carriers based on estimates of market power. Therefore, consistent with that long-standing regulatory framework, we do not find it necessary at this time to either impose retail service quality standards on all telecommunications service providers or to eliminate all retail service quality requirements for Verizon.[80]

However, the Department will consider the Attorney General's contention that Verizon's current service quality plan may be outdated. A majority of the existing service quality standards are based on 1992-1993 performance data (Exh. DTE-VZ 1-5), and, therefore, may be set at a level below that which is reasonable in today's marketplace. In the years since the development of the current service quality plan in the Department's Price Cap Order in 1995, the telecommunications industry has undergone significant changes, including the introduction of new technologies and an increase in the importance of network reliability. Therefore, the Department agrees with the Attorney General that it may be appropriate to conduct a comprehensive review of Verizon's retail service quality and service delivery throughout the state. The Department will consider whether opening such an investigation is appropriate.

In the interim, the Department determines that it is appropriate to accept Verizon's suggestion to continue the existing service quality plan (including Verizon's proposed revisions

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80 We likewise do not determine that our finding of sufficient competition for Verizon's retail business service in Phase I of this proceeding negates the need for continued monitoring of service quality for Verizon's business services. As the Attorney General has pointed out, a significant number of Verizon's competitors (namely, those that provide service through resale and UNEs) rely on Verizon's provision of service quality, and the Department must continue to enforce service quality standards to ensure that both Verizon's customers and customers of competing LECs continue to receive reasonable service.

to the penalty provision). Verizon has met or exceeded the service quality thresholds during the period covered by the last four annual price cap filings, and extending the existing plan will ensure that retail customers continue to receive customary levels of service quality while the Department conducts its review.

V. ORDER

After due notice, hearing, and consideration, it is

ORDERED: That Verizon New England, Inc. d/b/a Verizon Massachusetts' June 5, 2002 regulatory plan for Verizon's retail intrastate telecommunications services is approved in part, and denied in part, as set forth above; and it is

FURTHER ORDERED: That Verizon New England, Inc. d/b/a Verizon Massachusetts must submit a regulatory plan for Verizon's retail intrastate telecommunications services that is consistent with the determinations set forth above, and that this plan shall be filed with the Department no later than 30 days from the date of this Order; and it is

FURTHER ORDERED: That the December 13, 2002 Motion of AT&T for Summary Judgment or, in the Alternative, for Leave to Present Evidence and File Briefs Regarding Verizon's Failure to Comply with the Department's Phase I Order is dismissed, as set forth above; and it is

FURTHER ORDERED: That Verizon New England, Inc. d/b/a Verizon Massachusetts shall comply with all directives contained herein.

By Order of the Department,

____________/s/____________________
Paul B. Vasington, Chairman

____________/s/____________________
James Connelly, Commissioner

____________/s/____________________
W. Robert Keating, Commissioner

____________/s/____________________
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

ATTACHMENT
RI 3692
DIV 1-23 (MA 3)
VZ# 23

VERIZON MASSACHUSETTS

ALTERNATIVE REGULATION PLAN

MASSACHUSETTS ALTERNATIVE REGULATION PLAN

The Massachusetts Alternative Regulation Plan ("Plan") establishes the method by which the Department of Telecommunications and Energy ("Department") will regulate the Intrastate services Verizon New England Inc. ("Verizon MA" or the "Company") offers under tariff in the Commonwealth. The terms of the Plan are as follows:

A. Residential Basic Services - Except as provided in Paragraphs C and N below, prices for Residential Basic services shall not be increased. Residential Basic services are listed in Attachment A.

B. Residential Touch Tone Service – The monthly rate associated with Residential Touch Tone service is eliminated.

C. Residential Dial-Tone Line – The Residential Dial-Tone Line rate of $9.91 is increased to $12.36.

D. Lifeline Services – The Lifeline Credit will be increased by an amount equal to any increase in the Residential Dial-Tone Line rate implemented in accordance with Paragraphs C above and Paragraph N below.

E. Residential Non-Basic Services – Rates for Residential Non-Basic services and any new Residential Services will increase or decrease in response to market conditions. Pricing for these services will be at the discretion of the Company. Residential Non-Basic services are listed in Attachment B.

F. Retail Business Services – Rates for Intrastate retail Business services, except those described as price regulated in Attachment A, will increase or decrease in response to market conditions. Pricing for these services will be at the discretion of the Company, subject to any price floor requirement set by the Department. The retail Business services that are subject to full pricing flexibility are listed in Attachment B.

G. Retail Private Line Services – Rates for retail Private Line services will be regulated. Except as provided in paragraph N below, prices for these services shall not be increased. Private Line services can be restructured and repriced within the overall pricing restriction. Any reduction in prices must comply with the governing price floor requirements. Retail Private Line services are listed in Attachment A.

H. Other Wholesale-Like Services – Prices for selective retail PAL and PASL services that are primarily provided as wholesale services will be adjusted in accordance with the decision of the Department in Docket No. D.T.E. 97-88/18. Prices for collocation circuits that are primarily provided to carriers as wholesale services are adjusted to levels reflecting Unbundled Network Element ("UNE") rates. These services will continue to be price regulated. A list of these services is contained in Attachment A.

I. Switched Access Services – The rates for Intrastate Switched Access services will be changed to reflect the July 2002 rate levels associated with Interstate Switched Access services. Except as otherwise provided in Paragraph N below, Intrastate Switched Access rates shall not be increased.

J. Special Access Services – The rates and charges associated with Intrastate Special Access services will continue to be price regulated. Except as otherwise provided in Paragraph N below, Intrastate Special Access rates shall not be increased.

K. Special Construction Charges – The rates for Special Construction associated with Intrastate Switched and Special Access services will be based on the actual costs Verizon MA incurs.

L. Prices for access to Verizon MA's UNEs and interconnection with the Company's facilities and equipment, and the level of the Company's wholesale (resale) discount, will continue to be set in accordance with the federal Telecommunications Act of 1996, as amended.

M. Poles and Conduit and Late Payment Charges – Pricing requirements for these services, as established in the Department's Orders in D.P.U. 91-218 and D.P.U. 93-204-A, respectively, remain in effect until the Department otherwise orders.

N. All price-regulated services may be increased or decreased in the event of an exogenous event that increases or decreases the Company's cost of providing, or increases or decreases its revenues from, those price-regulated services. A party may petition the Department to recover positive or negative changes in costs or revenues because of an exogenous event in accordance with the provisions of this Plan. An exogenous event is one that is beyond the control of Verizon MA and that positively or negatively changes the Company's cost of providing service, or its revenues from those services. An exogenous event includes, but is not limited to: (i) changes in tax laws; (ii) changes in Generally Accepted Accounting Principles that apply specifically to telecommunications or changes in the Federal

Communications Commission Uniform Systems of Accounts; (iii) any Federal Communications Commission rules changes pertaining to jurisdictional separations; and (iv) regulatory, judicial, or legislative changes affecting the telecommunications industry, including rules and orders that are necessary to implement such changes. If the Department finds that Verizon MA has experienced a positive or negative change in costs or revenues due to an exogenous event, it shall allow the Company to reflect the amount of the change by way of surcharge, credit or rate adjustment as appropriate. If a dispute arises over whether an event is exogenous, the burden of proof lies with the party proposing the recovery or reduction. Any proposed exogenous adjustment must affect the Company's annual costs or revenues by at least $3 million.

O. Verizon MA may modify the application of rate elements so long as such modifications comply with all pricing rules.

P. Price floor rules that the Department established in D.P.U. 94-185 remain in effect, except as modified by the Department in its Phase I and Phase II Orders in D.T.E. 01-31.

Q. Verizon MA may petition the Department to modify any of the terms or conditions of the Plan: (i) to reflect the impact of relevant provisions or decisions, enacted or issued subsequent to the Department's approval of the Plan, of federal or state legislative, judicial or administrative bodies of competent jurisdiction; or (ii) to seek a less structured form of regulation or deregulation of its operations based upon changes in market conditions. In any proceeding, the burden shall be on the Company to establish the reasonable basis for the modification.

R. Verizon MA will continue to offer all of the Intrastate services provided under tariff as of the date of Department approval of the Plan unless it petitions and receives approval from the Department to withdraw a service.

S. Verizon MA will continue to file tariffs with the Department, as required by applicable law, for the telecommunications service offerings subject to its regulation within the Commonwealth. Such tariff filings will be filed for effect no sooner than 30 days following the date of filing, unless Verizon MA establishes good cause for an earlier effective date. Verizon MA will be required to produce only such data as needed to establish compliance with the terms of all pricing rules otherwise specified in the Plan.

T. The Service Quality Plan adopted by the Department in D.P.U. 94-50 shall be modified to reflect the change from an indexed price cap formula. The modified Service Quality Plan will provide a payment of one twelfth of one percent of annual retail revenue for every month that either the overall performance level is less than 33 points, or if three or more of the 12 individual service items that comprise the SQI fall below the standard threshold on a statewide basis in a given month. The payment would be made as a one-time credit to all Residential and Business lines on an annual basis. A copy of the modified Service Quality Plan is provided as Attachment C.

ATTACHMENT
RI 3692
DIV 1-23 (MA 3)
VZ# 23

VERIZON MASSACHUSETTS

ALTERNATIVE REGULATION PLAN

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Communications Commission Uniform Systems of Accounts; (iii) any Federal Communications Commission rules changes pertaining to jurisdictional separations; and (iv) regulatory, judicial, or legislative changes affecting the telecommunications industry, including rules and orders that are necessary to implement such changes. If the Department finds that Verizon MA has experienced a positive or negative change in costs or revenues due to an exogenous event, it shall allow the Company to reflect the amount of the change by way of surcharge, credit or rate adjustment as appropriate. If a dispute arises over whether an event is exogenous, the burden of proof lies with the party proposing the recovery or reduction. Any proposed exogenous adjustment must affect the Company's annual costs or revenues by at least $3 million.

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Q. Verizon MA may petition the Department to modify any of the terms or conditions of the Plan: (i) to reflect the impact of relevant provisions or decisions, enacted or issued subsequent to the Department’s approval of the Plan, of federal or state legislative, judicial or administrative bodies of competent jurisdiction; or (ii) to seek a less structured form of regulation or deregulation of its operations based upon changes in market conditions. In any proceeding, the burden shall be on the Company to establish the reasonable basis for the modification.

R. Verizon MA will continue to offer all of the Intrastate services provided under tariff as of the date of Department approval of the Plan unless it petitions and receives approval from the Department to withdraw a service.

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T. The Service Quality Plan adopted by the Department in D.P.U. 94-50 shall be modified to reflect the change from an indexed price cap formula. The modified Service Quality Plan will provide a payment of one twelfth of one percent of annual retail revenue for every month that either the overall performance level is less than 33 points, or if three or more of the 12 individual service items that comprise the SQI fall below the standard threshold on a statewide basis in a given month. The payment would be made as a one-time credit to all Residential and Business lines on an annual basis. A copy of the modified Service Quality Plan is provided as Attachment C.

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-851

June 25, 2001

MAINE PUBLIC UTILITIES COMMISSION
Investigation into Verizon Maine's Alternative
Form of Regulation

ORDER (Part 2)

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

TABLE OF CONTENTS

I. SUMMARY AND INTRODUCTION

In this Order we extend the Alternative Form of Regulation (AFOR) for Verizon Maine (Verizon) until May 31, 2006.[1] We modify the plan by allowing Verizon additional pricing flexibility. We also allow the Company to raise its basic local rates by $12.5 million annually to balance the recent access reductions required by Maine law. Basic rates will increase by $1.78 per line per month, except for Centrex lines, which increase by approximately one-third of the full per-line increase, and flat-rated PBX trunks, which increase by 150% of the per-line amount.[2] Basic service provided for resale will continue to be subject to the existing wholesale discount contained in the reseller's interconnection agreement. The rates for customers served under Lifeline rates will not increase.

We will not allow Verizon to increase basic rates to offset any future lost retail toll revenues because we expect that continuing productivity gains and revenue increases from other services will equal or exceed the amount of any such lost toll revenues. We will, however, require the Company to make a filing showing either that it has experienced an actual revenue decrease from retail toll services of $19.8 million or that it has reduced its rates by that amount. If the Company cannot show that its intrastate toll rates and/or revenues have decreased by $19.8 million, the Commission may require Verizon to file tariff changes to bring about the remainder of the reduction.

Beyond the initial increase no increases for basic rates for inflation will be permitted during the term of the AFOR. Barring adjustments for exogenous events, those rates will remain capped through May of 2006. We also cap the charges for two other services (Directory Assistance and Operator Service) that currently do not exhibit effective competition. We will allow the Company at any time during the remainder of the AFOR to present evidence to the Commission that effective competition exists for multi-line (defined as 10 or more access lines) business customers on a wire center or an exchange basis. If the Commission finds that effective competition is present in the wire center or exchange, Verizon will no longer be bound by the cap for multi-line business customers in that wire center or exchange.

For all other retail services, the Company has pricing flexibility, but we will open a proceeding shortly that will examine whether optional calling features exhibit characteristics that require some form of price regulation. Because the Company retains a virtual monopoly over the residential and small business customer market, and because most of the optional calling features cannot be obtained from another source, the Commission will examine the need for some level of price protection for these services. Rates for intrastate access service will continue to be set in accordance with

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[1]The Procedural History of this Investigation is contained in Appendix A.

[2]Chairman Welch's separate concurring opinion on this subject appears at the end of this Order.

the provisions of 35-A M.R.S.A. § 7101-B, and wholesale rates will remain subject to the provisions of the Telecommunications Act of 1996 (TelAct).

The revised AFOR will have a term of five years. 35-A M.R.S.A. § 9103 (1) states that "the alternative form of regulation…may not be less than 5 years nor exceed 10 years without affirmative reauthorization of the commission…." We initially ordered that the first phase of the AFOR would be in effect for five years (from December 1, 1995 to November 30, 2000), but we extended that term for an additional half year. Accordingly, the two phases of the AFOR will be in effect for a total of 10½ years. We therefore expressly affirmatively reauthorize the AFOR for an additional five years, for a total of 10½ years.

During the next five years we anticipate that competition will likely become the major factor in shaping the telecommunication industry and the way that Verizon conducts business in Maine. While we recognize that ubiquitous competition for all types of customers and services may be slow to develop fully in Maine, which has many high-cost exchanges, we will take all reasonable steps to ensure that economic competition develops as quickly as is reasonably possible. We recognize, however, that we cannot force competition to materialize and take hold when it is not economically justified.

We also will continue the Service Quality Index (SQI) mechanism that we adopted for the initial phase of the AFOR, but we modify certain attributes of the plan. We increase the total number of indices to 15, increase the maximum amount of penalty applicable to each metric, and increase the total amount of annual penalty for which the Company may be liable. Each index, except the Service Outage index, will have a maximum annual penalty of $1.135 million. The Service Outage metric annual maximum penalty will be $2.27 million, and the maximum total annual penalty will be $12.5 million. We also eliminate four of the current measures, change four (including separating a current single measure into two separate metrics) and add five new indices. For the new indices, we will calculate the baseline measurements from the most recent 3-year average data, but we retain the existing baselines for the five unchanged indices.

II. BACKGROUND AND OVERVIEW

A. The First Phase of the AFOR

The Commission adopted the AFOR in 1995 for a 5-year period, later extended for an additional half year. This phase of the AFOR terminated on May 31, 2001. (Throughout this Order we refer to the AFOR in effect from December 1, 1995 to May 31, 2001 as the "initial phase" or the "first five years" of the AFOR). During its term, Verizon's core rates have been reduced by an average of 12.5%. While basic rates were increased by $3.50 in three steps as a result of a stipulation to allow the Company to offset part of the reductions to access rates mandated by Section 7101-B, we believe that ratepayers today are the same or better off than they would have been without the implementation of the AFOR, as required by 35-A M.R.S.A. § 9103(1). The most significant price decreases have been in toll, due to the access charge reductions and the substantial level of competition in the toll market.

Since we implemented the AFOR, two major new laws, one Federal and one State, have significantly affected the telecommunications industry. The Federal Telecommunications Act of 1996 (TelAct) provided the basis and terms under which local exchange service was fully opened to competition. The TelAct set forth the principles under which competitors could enter the local exchange market by using their own facilities interconnected with those of the incumbent local exchange carrier (ILEC), or by using all or portions of the ILEC's local network facilities (by purchasing Unbundled Network Elements, or UNEs), or by reselling the ILEC's local service in its entirety. The TelAct established the obligations of ILECs to make their services and facilities available to competitors, and it spelled out the procedures that must be followed in reaching agreements for interconnection, use of UNEs or resale. The TelAct continued the Modified Final Judgment (MFJ) prohibition against (RBOCs) provision of interLATA traffic by the former Bell operating companies within their local service territories until they proved that their local markets were opened completely to competition.

The second change in law occurred in 1997. The Maine Legislature enacted 35-A M.R.S.A. § 7101-B, which requires "access parity", i.e., every Maine LEC's intrastate access charges must be less than or equal to its interstate access charges. Although the access parity statute was enacted in 1997, it required LECs to make their first access charge reductions on May 30, 1999, about three and a half years after the AFOR began.

The anticipated effect on Verizon's access and toll revenues of the access parity statute led to the Commission's acceptance of a stipulation that increased basic exchange rates in a 3-step process (which involved a waiver of the original AFOR pricing rules governing basic exchange service rates) but decreased intrastate access rates to their interstate level on May 30, 1999, as required by the statute. The statute requires that intrastate access rates be readjusted every two years to levels that are equal to or less than the federal levels. The second adjustment occurred on May 30, 2001.

While the statute directs the Commission to take action regarding access rates, the intent of the statute is to remove one of the major impediments to lower intrastate toll rates. Under subsection 3, the Commission has the authority to require that the access rate reductions be passed along to consumers through lower toll rates if it finds that effective competition does not exist in the in-state toll market. To date, the Commission has not found it necessary to use its authority to lower toll rates, as the available evidence suggests that effective competition is present in this market.

B. Consideration of Statutory Objectives for the Revised AFOR

The Commission must consider revisions to the AFOR with these changes in the telecommunications environment in mind. The Commission remains committed to relying on competitive forces to guide the telecommunications marketplace in Maine, but we must ensure that consumers are protected with respect to services whose markets are not yet effectively competitive. Against this background, we turn to a review of the AFOR standards set forth in 35-A M.R.S.A. §§ 9101 – 9105.

Section 9103 sets forth nine objectives. In our AFOR Order in Docket 94-123, we found that the AFOR met, or was very likely to meet, each of those objectives. In the Further Notice of Investigation (FNOI), issued in this Docket on June 26, 2000, we described how the AFOR, with the proposed revisions, would continue to satisfy the provisions of the statute. Nothing we do in this Order by way of modifying the AFOR alters our conclusion, reached previously, that both the initial and revised AFOR fully meet all nine objectives, and we will not repeat our discussion of all of those objectives here. We will, however, expand on our analysis of some of those requirements.

The first objective requires that the term of the AFOR not exceed ten years nor be less than five years, and that residential and small business ratepayers not be required to pay more for local service as a result of the implementation of the AFOR than they would under traditional rate base or rate of return regulation. In our original AFOR Order, we also decided that toll rates should also be priced as low or lower under an AFOR than they would under traditional regulatory ratemaking principles.

During the initial phase of the AFOR, most of the rate reductions required under the operation of the price cap mechanism (the "Price Regulation Index" or PRI) went to the toll market, which is the most competitive telecommunications market in Maine. During that first phase, we also approved a stipulation that contained, as one part, an increase to basic exchange rates, notwithstanding the AFOR pricing rule that prohibited increases to basic local rates unless the PRI was positive. (The PRI never was positive during the 5 ½ years of the initial AFOR). The increase to basic rates, therefore, was not the result of the operation of the AFOR. Instead, it was the product of the statutory mandate that intrastate access rates be set equal to those established by the FCC for interstate access. Implementing the statutory mandate resulted in a significant decrease in intrastate access and toll revenues for Verizon, and the Commission found it reasonable to allow the Company to offset a portion of the estimated revenue loss with an increase to basic exchange rates, largely because only basic exchange rates could produce sufficient revenues to offset the effects of implementing the statute.

In this proceeding we were again faced with the need to adjust intrastate access rates downward on May 30, 2001, in order to comply with the provisions of Section 7101-B. The decrease is smaller than the one associated with the 1999 adjustment, but still will result in a significant reduction in the Company's revenues. As we did in 1999, in this Order we allow Verizon to increase its basic rates to offset a portion of the revenue reductions that will result from the access parity statute. Our action here complies fully with the fifth objective of Section 9103, which requires that customers pay only "reasonable charges for local telephone services," when taken together with the sixth objective, which states that an AFOR must ensure that the telephone company has "a reasonable opportunity to earn a fair return on the investment necessary to provide local telephone services."

The Commission is obligated to consider the interests of both ratepayers and the Company when it establishes local rates under an AFOR, and we have continued that balancing of interests in the revised plan. Local rates remain reasonable, and customers are protected from additional increases. Customers also should see the benefits of reduced toll rates, while the Company is given the opportunity to earn a reasonable return on its investment necessary to provide local service. It is also given pricing flexibility for its optional calling services, which will allow it to price these services at levels that will optimize its revenue. Further, to the extent that the Company can become more efficient while maintaining its service quality at acceptable levels, it will keep the rewards. Conversely, if the Company is not efficient or if it loses customers to competitors, it will not (except under extraordinary circumstances) be permitted to ask the Commission to assist it in reviving its earnings.

In this docket the Company has made several assertions about its inability to increase its revenues and, consequently, its earnings, given the general condition of the economy in Maine and the changing telecommunications environment. We decline to rely to any extent on these assertions. Indeed, the Company's position here is ironic in light of its vigorous opposition to the Public Advocate's request to conduct an earnings investigation for Verizon. In rejecting the Public Advocate's request, we made clear that we did not consider Verizon's revenue requirement or earnings to be relevant to the issues involved in continuing and revising the AFOR.

We reiterate that earnings are irrelevant to the form of the revised AFOR. Nevertheless, Verizon's claims should not go unanswered. First, we observe that over the five years ending in December, 2000 , the Company's intrastate earnings grew at an average annual rate of 5.7%, even though its revenue growth averaged only 2.6%. Apparently, the Company has been able to generate enough efficiencies in its operations to overcome the AFOR-induced rate reductions of about 12.5% during the initial phase of the AFOR. Based on its reported results during the initial phase of the AFOR, the Company cannot claim that its financial results have been unacceptable, especially when compared to what might have occurred under rate of return regulation. We firmly reject any policy that would employ incentive regulation only when a utility's business is prosperous, but would revert to a rate of return approach when earnings decline.

In summary, there is no evidence to support any claim that the Company has been disadvantaged financially by the initial phase of the AFOR, or to support the claim that the Company will not have a continued opportunity to perform well financially in the future, provided it can operate efficiently (while maintaining acceptable levels of service quality) and meet the competitive threats of the marketplace. The telecommunications market may be shifting, but there is no evidence indicating that it is a long-term declining market, and Verizon has every opportunity to participate and prosper in that market.

The Company also claims that its growth rate in access lines has turned negative, as cable modems replace second lines for Internet usage and competitive LECs pursue the Company's most lucrative business customers. The Company appears to be suggesting that it has no growth opportunities left in the telecommunications area. While the Company's traditional sources of revenue may decline in the future, we expect that, as in the past, new opportunities for increased revenues will continue to emerge in the telecommunications industry, especially for a company that already has in place a ubiquitous and vibrant infrastructure.

Finally, we discuss two other objectives contained in Section 9103 that are related in purpose: number 4 ("Safeguards") and number 7 ("Encourage telecommunications services"). The fourth objective requires that the AFOR protect local service subscribers from the risks associated with the "development, deployment and offering of telecommunications and related services offered by the telephone utility, other than local service;" it also requires that the utility continue to offer a "flat-rate, voice-only local service option." Objective number 7 requires the AFOR to "encourage the development, deployment and offering of new telecommunications and related services in the State."

The initial phase of the AFOR accomplished these objectives in part by permitting limited or no increases to local service rates, although we did permit one exception to that rule because of the requirements of the access parity statute. The revised AFOR accomplishes these objectives in part by allowing Verizon to increase its basic rates by only a portion of the amount necessary to offset the revenue losses from mirroring interstate access charges. Both the initial phase and the revised AFOR allow the Company a reasonable opportunity to earn a fair return on its local network investment. The initial phase of the AFOR allowed the Company complete pricing freedom on all new services, by making them non-core services, and excluded them from the rates that were subject to the PRI, thus insulating local ratepayers from the risks of those services. The revised AFOR expands the pricing flexibility afforded Verizon, in that the Company is allowed to adjust the prices in any direction for almost all its services without price cap restrictions. Verizon has the ability to price its discretionary services at the level that will maximize its revenues; it can compete with alternative service providers; and it can offer advanced services through its affiliate, VADI, subject to FCC merger conditions. Verizon assumes the risks and earns the rewards of its actions according to its ability to offer services and products that customers will buy.

The Executive Branch (EB) agencies of the State of Maine have proposed that we adopt specific infrastructure investment requirements for Verizon to ensure that telecommunications technology in Maine is similar to that deployed by Verizon in the more urban parts of its service territory. We decline to adopt that proposal as discussed in greater detail in Part VIII.

III. AFOR STRUCTURE; PRICING RULES

A. Basic, Directory Assistance and Operator Services

As we proposed in the FNOI, we will not adopt a price index (e.g., a PRI) for any group of services. Three retail services (basic local exchange, directory assistance, and operator services) will be subject to direct price regulation by the Commission; the Company will not be allowed to raise prices for those services except as described below. Access and wholesale services will be subject to regulation pursuant to statutes. The Company will have pricing flexibility for all other services. Depending, however, on findings we make in a proceeding that we will conduct to address whether certain optional calling features have become "basic" or essential, we may decide that some form of price regulation is necessary for some or all of those services. While we do not adopt a PRI that contains a formal recognition of productivity gains, we find that productivity for Verizon will continue to increase. We rely on those productivity gains (along with increases to revenues for other services) to offset expected decreases to retail toll revenues. We explain our reasons for this decision in Part V.

During the term of the revised AFOR, we will not allow Verizon to increase its rates for basic exchange service beyond the increases specified in this Order to offset the access rate reduction that occurred on May 30, 2001. We will, however, as described below, permit Verizon pricing flexibility if it establishes that reasonable competitive alternatives exist for segments of the local exchange market. Based on the testimony of Public Advocate witnesses Norton and Sweet, we cannot find at this time that there is any effective local exchange competition for local exchange customers with the possible exception of business customers with large numbers of lines.

We also will not allow Verizon to increase its prices for operator or directory assistance (DA) services, unless Verizon can show a cost basis for such a change or that either of these services has become competitive. We describe our reasons for this decision in Part VI.

During the revised AFOR, the Company may present evidence showing that a competitive market exists for residential or business local exchange service, or for operator or directory assistance services. If we find that a competitive market does exist for any of these services (or a subset of any service), we will allow Verizon increased pricing flexibility for that service. In particular, Verizon may attempt to establish that a competitive market exists for local service for multi-line (10 or more) business customers. Verizon may make such a showing on an exchange or wire center basis. At a minimum, Verizon must show that one or more facilities-based CLECs have facilities in place to provide service to customers with ten or more lines, but it also must show that the CLECs are actively marketing and providing their services to such customers. Whether CLECs provide service throughout the entire wire center is another factor we will consider in determining whether competition is effective.

B. Toll and Wholesale Services

For retail toll services we find that there is effective competition. We will permit Verizon pricing flexibility for those services. We find that the retail toll market has been effectively competitive for several years. Verizon may change its rates for all retail toll services at any time, provided it files tariff changes with the Commission and provides notice to customers as required by statute or Commission rules. Verizon must, however, meet the revenue or rate reduction requirements described in Part V.

Rates for all wholesale services will continue to be set in accordance with statutory provisions. Rates for intrastate access are governed by Section 7101-B, and wholesale rates for unbundled network elements, interconnection and local resale are subject to the provisions of the TelAct.

C. Optional and Enhanced Services

Optional and "enhanced" services constitute a large category of Verizon services. These services include optional services such as call waiting, call forwarding and three-way calling, as well as CLASS services such as caller ID. There are few competitive alternatives for most of these services. They can be obtained only from the LEC that provides the customer with local service; it is not possible to obtain local service from one LEC and optional calling features from another. For most of these services there are no reasonable substitutes available from non-LEC sources. Answering machines may serve as a substitute for voice mail, but have the disadvantage that it is not possible for a caller to reach an answering machine if the line is busy.

Nevertheless, despite the fact that competitive alternatives for many of these alternative services are scarce, it is possible to find (as we did under the present AFOR) that they are "discretionary" in nature and that Verizon should be permitted pricing flexibility. All of these services are "discretionary," at least in the sense that they are optional. Customers do not have to take any of these services; they are not included in mandatory bundled packages with basic or toll services. A further meaning of "discretionary" is more relevant to our decision about the degree of regulation that is necessary. A service is "discretionary" if it is one that is not necessary for most customers and is typically characterized by a high elasticity of demand, such that many customers will not purchase (or continue to purchase) the service if the supplier raises the price too much. The nature of the demand for the service contains a built-in check on pricing. In the first five years of the AFOR, we granted Verizon pricing flexibility (subject, however, to the overall price cap of the PRI) for a broad category of services we determined were “core discretionary.” That category included nearly all of Verizon’s services, other than the three whose prices cannot be increased under the revised AFOR, plus retail toll. We also included “new” services in a category called “non-core.” We permitted Verizon total pricing flexibility for those services, not subjecting them even to the overall price cap. New services included Voice Mail and various bundled packages of optional calling features that were otherwise classified as core discretionary.

Under cost-of-service regulation, the prices for these optional services were generally set at levels to “maximize” the contribution from these services to “residually” priced services (generally basic exchange service). The price that a company will set for a product that is subject neither to price regulation nor competition will likely be the same – i.e., a price designed to “maximize” the profit (i.e., “contribution”) from that product. We therefore doubt if there was much difference between the pricing principles that applied to these services under traditional regulation and under the first phase of the AFOR.

Nevertheless, the Public Advocate has suggested that some of the optional calling features have become “essential” and that Verizon should not be permitted total pricing freedom. While we do not believe that the record was sufficiently developed in this case to make a finding about the Public Advocate’s hypothesis, we share the OPA’s concern that customers, in effect, may have redefined basic service to include some of these services. As discussed above, most of these services may be obtained only from a customer’s LEC. Accordingly, it is appropriate to ask whether stricter rate regulation is necessary, and we will open a proceeding to address that question. Until we conclude that proceeding, we will permit Verizon pricing flexibility for those services. Any price increases, however, may be subject to reversal at the conclusion of the proceeding.

D. Other Pricing Principles

As under the present AFOR, Verizon may not price any rate below the long-run incremental cost (LRIC) of providing the service, but the Commission will not investigate any rate decreases unless a complaint is filed that alleges a violation of this rule.

Finally, we will allow Verizon and others to request the recovery or passing through of positive or negative “exogenous” changes in costs or revenues, using the same definition of exogenous changes that we applied during the first phase of the AFOR, after amendment of that definition in the stipulation we approved in Docket No. 94-254 in 1998. Because we apply that definition to two issues in this case (access and toll revenue losses), we provide greater detail in our discussion of those issues at Parts IV and V below.

IV. ACCESS REVENUE REDUCTION; INCREASE TO BASIC RATES

Pursuant to the requirements of 35 M.R.S.A. §7101-B and the rules of this Commission, Verizon must reduce and restructure its intrastate access charges so that they are at or below the level of interstate access charge rates. The OPA estimates that the revenue impact of that reduction will be $8.4 million. Verizon estimates that the reduction in access rates will reduce its access revenues by $14.4 million.

The OPA's estimate of the access revenue reduction assumed growth in access use demand based on past growth trends. Verizon's estimate did not appear to take into account any growth in access minutes.

We find that the OPA's estimate of the loss of access revenues is understated for several reasons. In general, stimulation studies are often quite speculative, and this Commission has been reluctant to rely heavily on them. OPA witness Kahn's growth estimates assume a continued growth in access minutes that probably was caused in part by the introduction of Intra-LATA presubscription (ILP), resulting in migration of some Verizon retail toll customers to other interexchange carriers (IXCs) and an increase in access minutes paid by those carriers. ILP, however, was a one-time event. Dr. Kahn's estimates also do not recognize any possibility that some of the growth in competitive IXC traffic (and, therefore, access minutes) that have occurred in the past may not continue because Verizon's own toll rates have become more competitive. Finally, Dr. Kahn ignored the possibility that as facility-based CLECs gain customers, some access service that Verizon presently provides will be diverted to those CLECs. (Verizon may, however, receive revenue from providing unbundled network elements (UNEs) to those CLECs.)

We also find that Verizon's estimate of $14.5 million access revenue loss is somewhat overstated. While the growth in access minutes is not likely to be as great as Dr. Kahn's estimate, it will not be zero. Some growth in interexchange carrier minutes is likely to continue. We find that it is reasonable to expect a moderate growth in access minutes and therefore find that Verizon is likely to incur an annual access revenue loss of $12.5 million.

We must decide whether we should allow Verizon to recover the $12.5 million access revenue loss through an increase to some other rates, and, if so, the method of that recovery.

We decide that we should permit that recovery in part because the access charge reduction is required by law, and in part because of our decision, in Part V, that we will not allow direct recovery, through immediate rate increases for basic services, for toll revenue losses. In Part V, we find that Verizon should be able to meet the need to lower toll to meet competitive pressures through increases in productivity and increased revenues for other services. It is not reasonable, however, to expect that Verizon should also be able to absorb the access revenue reduction of up to $12.5 million.

In the revised AFOR we do not continue the PRI that was part of the initial AFOR and its formal method of adjusting rates to compensate for significant "exogenous" changes in costs or revenues. Nevertheless, Verizon has presented reasonable arguments that the access charge reduction mandated by statute is in the nature of an "exogenous" change to revenues as defined by the first AFOR Order, as amended by the Stipulation approved in 1998 (also in Docket No. 94-123) that addressed the first round of access charge reductions required by 35-A M.R.S.A. § 7101-B. As discussed in more detail in Part V below, under the revised AFOR we will continue the same definition of exogenous changes in costs and revenues that we applied during the first phase of the AFOR.

The access revenue loss directly attributable to the operation of the statute is beyond Verizon's control and is unique to the telephone industry; it has a "substantial and disproportionate" effect on its revenues. Because we will not allow Verizon to recover retail toll revenue losses through increases to price-capped rates, we find it reasonable to allow it to recover the estimated access revenue loss of $12.5 million.

We note that under the operation of the PRI and the pricing rules of the initial five years of the AFOR, Verizon could have recovered some of the lost access revenues even without the characterization of that loss as "exogenous." Under the PRI, if Verizon reduced rates for whatever reason, it was allowed to increase rates (within the core discretionary category) to make up for the reduction, provided that its overall rate level remained within the limit established by the PRI. A similar ability will continue under the revised AFOR because Verizon will have pricing flexibility for most services. However, there may be occasions when Verizon or any other party believes that a cost or revenue change should be considered exogenous and should be recovered from or serve to reduce other rates. In that event, the party will need to seek a ruling from the Commission.

Verizon's witness Dinan proposed two methods for recovery of the access revenue loss:

(1) Increases in basic service rates;
(2) Implementation by Verizon of a Carrier Market Share Charge (CMSC) that would apply to interexchange carriers.

The access parity statute, 35-A M.R.S.A. § 7101-B, requires access rates that are equal to or less than federal access charge. It also states that the Commission must establish (and reestablish every two years) intrastate access rates that are less than or equal to interstate rates "notwithstanding any other provision of law."[3] Prior to

[3] In addition, Section 7101-B requires a setting of access charges without reference to the costs of providing access service.

the enactment of section 7101-B, we had construed the "basic rates that are as low as possible" provision of 35-A M.R.S.A. § 7303(2) as a rate design directive.

However, the "notwithstanding" clause of section 7101-B is intended to override other provisions of law, such as section 7303(2), to the extent there is a conflict between competing policy goals. We have found that the access rate reductions are exogenous and that recovery through other rates is appropriate. We also cannot read section 7101-B to require access rate reductions "notwithstanding" the constitutional prohibition against confiscation. It is the obligation of agencies and courts to construe statutes in such a way that they are constitutional. It is not practical to raise retail toll rates because of competitive market pressures that will tend to lower prices in the retail toll market. In addition, a provision of the access parity statute itself requires the Commission to require retail toll rate reductions if it finds that a competitive toll market does not exist.[4] Thus, "notwithstanding" the "lowest possible" language of section 7303(2), we find it is necessary to raise basic rates to address the revenue losses due to the access reduction. The resulting increased rates are as low as "possible" under the circumstances.

We decline to adopt the Carrier Market Share Charge (CMSC) proposed by Verizon or the universal service fund proposed by the Examiner's Report, to recover the $12.5 million. Verizon proposed that the CMSC would recover lost access revenue through an assessment on interexchange carriers (IXCs), based on each carrier's share of the total number of access minutes. AT&T and the Public Advocate argued that the CMSC proposed by Verizon would be unlawful, on the ground that the charge would be a thinly disguised access charge or access charge surcharge, with the result that Verizon's access charges effectively would exceed the level required by section 7101-B.

In addition to the legal question regarding the CMSC plan, we are concerned that a USF adds another level of governmental involvement and complexity as well as administrative costs that are likely to be high compared to the $12.5M size of the fund. A USF would also require a rulemaking that would take at least two months to complete and the need to hire an administrator. *See* 35-A M.R.S.A. § 7104 (3). Finally, while a USF would serve the purpose of spreading the access loss among a larger base of telecommunications users, Verizon customers would probably pay a considerable portion of the costs of the fund.

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[4]Subsection 3 of section 7101-B states:

> If the commission finds that effective competition in the intrastate interexchange market does not exist, the commission shall require all persons providing intrastate interexchange service to reduce their intrastate long-distance rates to reflect net reductions in intrastate access rates ordered by the commission pursuant to subsection 2.

On balance, we believe that it is preferable to recover the $12.5 million in lost access revenues through an increase to basic rates. The first access rate reduction in May of 1999 was substantially larger than the present reduction. To recover that revenue loss, we approved a stipulated basic rate increase of $3.50 a month. Despite that increase, subscriber penetration rates actually increased. In this case we find that an increase of $1.78 a month is sufficient to recover the $12.5 million. The increase will apply to all access lines, including business lines. Business customers are likely to see substantial benefit from the reduction of access rates and therefore should absorb some of the access revenue loss. We will exempt Lifeline customers from any increase to minimize any possible losses in subscribership caused by the increase.

The Public Advocate has presented two other arguments against increasing basic rates that we find necessary to address in this Order.

First, the Public Advocate stated in its exceptions that it "objects to the incorporation of the May 2001 access change into this proceeding," stating that "this proceeding was never formally noticed as a vehicle for consideration of that issue" and that "while the Public Advocate provided some testimony concerning that issue, he was not on notice that this would be the only opportunity to rebut the Company's assertions concerning its projected access revenue losses." We find that the Public Advocate did receive adequate notice that this issue would be addressed. The Notice of Investigation (December 27, 1999) in this case was sent to the Public Advocate. Part III of the Notice stated that "several events that occurred after the adoption of the [initial] AFOR …may need to be considered in deciding its future." One of the four listed events was "Access Rate Reductions" that were required by 35-A M.R.S.A. § 7101-B. The description of this event included the process, during the initial phase of the AFOR, by which basic rates were raised. In addition, the second Part III of the Notice (there are two Part IIIs), entitled "Issues To Be Considered," listed "pricing rules" among those issues.

The Further Notice of Inquiry (FNOI) in this proceeding, issued on June 26, 2000, provided substantial additional notice that the basic service rates would be an issue in the case. The FNOI proposed to cap basic rates at their present level and effectively to incorporate the access rate reductions required by law as a feature of the AFOR:

> The proposed AFOR will cap basic rates for the duration of the plan, and it will require BA-ME to reduce its access rates according to the provisions of 35-A M.R.S.A. §7101-B. We also expect that the access rate reduction will lead to lower in-state toll rates, and thus, we are effectively ordering a rate reduction for the Company that it cannot recover through increased basic rates.

This proposal surely would permit a party to argue for alternative approaches to the issue of basic rate levels and, in particular, whether a combination of access rate reductions and capped basic rates was appropriate. Part VI of the FNOI (entitled "Pricing Rules"), also tied these two issues together:

> Although not an AFOR pricing rule, we must, of course, continue to enforce the provisions of §7101-B by requiring that intrastate access rates remain equal to or less than the interstate access rates at the dates specified in the statute. Basic rates will be capped at their present levels for the term of the AFOR… .

Throughout this case, both parties have advocated different approaches to the issue of appropriate basic rate levels. The Public Advocate has argued that a price cap formula (such as the PRI in effect during the first five years of the AFOR) should remain in effect and that Verizon should be required to *reduce* basic local rates consistent with changes in the PRI. Since at least the filing of its prefiled testimony on January 8, 2001, Verizon has argued that the access rate reduction required for May 30, 2001 should be offset in part by a basic rate increase.

We find that the Public Advocate received adequate notice that this proceeding would consider the issue of basic rate levels in conjunction with the access rate reductions required by statute.

The Public Advocate also claims that we should not permit Verizon any recovery of revenues it may lose as a result of the access rate reductions because Verizon was involved in causing the need for those reductions. In a recent proceeding before the FCC, Verizon, as a member of the Coalition for Affordable Local and Long Distance Services (CALLS), advocated interstate access reform that included a substantial reduction in interstate access rates. The FCC adopted the CALLS proposal in modified form following input from a broad range of parties.

Under 35-A M.R.S.A. § 7101-B, a carrier's intrastate access rates may be no higher than its interstate rates. The reduction in Maine's intrastate access rates is due to the direct mandate of that statute and to the FCC's action in reducing interstate access rates. Verizon's role is indirect. Certainly, within the meaning of the definition of exogenous changes in revenues, it is a change that was not within its control.

Verizon undoubtedly has the right (as has this Commission and the Public Advocate), to advocate in a federal forum, what it believes is in its overall best interest, even though the result it advocates may result in effects elsewhere that others find undesirable. We reject the suggestion that Verizon should be precluded from any recovery of access revenue loss because of its role in the federal proceeding. We also note that in the federal proceeding the FCC ordered an increase to the Subscriber Line Charge (SLC) that is paid by end users. That charge is in effect a basic service rate component of interstate rates.

Finally, we address an issue raised by Verizon in its exceptions that the Examiner's Report failed to address, namely, whether and how Verizon should be allowed to recover for further access rate reductions (approximately $2-3 million) that

Verizon will have to make in May of 2003. This additional reduction is caused by the operation of the CALLS plan, which phases down the per-minute access rates. We will not decide at this time whether these access rate reductions, which are considerably smaller than the 2001 reductions, should constitute an exogenous change and should require an increase to basic rates. Like the 2001 reductions, they are required by law, but their size may raise questions about whether they should be considered exogenous and subject to a pass-through in rates. We leave to Verizon to decide whether it should seek to justify, under the rules of the revised AFOR, any changes to basic rates based on the 2003 access reductions.

V. TOLL REVENUE LOSS

As discussed above, Verizon should recover, through an increase in basic rates, the revenue loss for the known and immediate (May 30, 2001) reduction it must make in access charge rates. The access rate reductions are a direct and unavoidable consequence of the operation of the access parity statute, 35-A M.R.S.A. § 7101-B. By contrast, the access parity statute only indirectly affects retail toll rates and revenues; other factors also have an influence. It is likely that Verizon will have to reduce retail toll *rates*, although access charge changes probably are not the only influence on intrastate toll rates. Verizon's retail toll *revenues* may also decline, although changes (positive or negative) in Verizon's retail toll market share could have as substantial an influence on its retail toll revenues as the access rate reductions. The ultimate level of Verizon's retail toll rate and revenue reductions will be the result of many factors, including the fact the Verizon has some control over their magnitude through pricing strategy, marketing and retention or increases in market share. The reductions also will not occur immediately, and their amounts are far from certain.

We find that Verizon will be able to absorb the toll revenue losses through productivity gains, even though we do not implement a PRI or apply a productivity factor to any service, and through increases in revenues from other services.

Verizon has demonstrated under the present AFOR that it has been able to absorb rate reductions each year of approximately $7.5 million. Over the 5-year span of the initial phase of the AFOR, rates have been reduced by $38 million, or by 12.50%, as shown by the change in the price regulatory index (PRI) (the price cap) from 100 to 87.51 and the change in the actual price index (API) from 100 to 87.50.

Notwithstanding the *rate* reductions that Verizon absorbed during the present AFOR, Verizon's intrastate *revenues* during the 5-year span have increased by about $45 million, i.e., from about $321 million to about $366 million. Under the revised AFOR, the revenues within the former "core nondiscretionary" category may decline because access and retail toll constitute such a large proportion of that category, and Verizon will not be able to increase basic service rates beyond the $1.78 monthly amount that we allow in this order. However, there is no reason to believe that revenues for the former core discretionary and non-core categories will not continue to increase. In particular, because of strong customer demand, a substantial potential exists for increased revenues from high-speed data services.

We also observe that the nature of productivity gains is cumulative. If a utility achieves a gain in efficiency of $ X in one year and an additional $ X in the next, the total cost savings in the second year is $ 2X. By contrast, the loss of retail toll revenue that may result from a one-time decrease in access charges occurs once, even though the change is likely to be permanent. (It may take more than one year for the full amount of the reduction to be realized, however.) Thus, even though the projected (or finally realized) amount of toll revenue loss is larger than a single year's productivity gain, the cumulative nature of productivity gains is likely to overcome the one-time nature of a toll revenue loss reasonably quickly. We recognize that there may still be a timing difference between a substantial reduction in retail toll revenues (particularly if the toll revenue loss occurs very quickly) and Verizon's ability to absorb those losses through productivity gains and increases to other revenues.

Verizon has argued that both the access reductions and retail toll revenue reduction are "exogenous." We note that under the first phase of the AFOR, an "exogenous" change in costs or revenues is strictly defined and used as a factor in the price cap formula (the PRI). If an exogenous change occurs, it directly affects the allowed level of core rates. The revised AFOR will not recognize an "exogenous" change in costs or revenues in a formula that determines a maximum overall level of rates. Nevertheless, under the revised AFOR, we will allow exogenous changes to be recognized in rates when it is appropriate to do so, and we will use the same definition for exogenous changes in costs or revenues that we used in the first five years of the AFOR.[5] In applying that definition to the question of retail toll revenue changes, we cannot agree that they are "exogenous." The definition requires that an exogenous change be outside the control of Verizon. Verizon clearly has considerable (though obviously, in light of market forces, not unlimited) control over its retail toll revenues, and, even though the access parity statute may also indirectly influence their ultimate level, it will not be possible to identify the extent of any single influence.

For the revised AFOR we do not establish a formal pricing index or productivity factor. We also do not make a specific finding that productivity will occur at any particular level. However, we do find that Verizon will be able to absorb rate reductions of approximately the same magnitude as under the present AFOR because of continued productivity gains and increased revenues for services other than basic, toll and access.

The evidence in this case does not persuade us that productivity is likely to be substantially higher or lower than we found (and incorporated in the PRI) in the present

[5]The definition in the original AFOR Order in Docket No. 94-123 (May 15, 1995) was restricted to changes in costs. In a subsequent Order issued on March 17, 1998 in the same docket, we approved a Stipulation that modified the definition to include changes in revenues, provided that the events that cause revenue changes "satisfy the conditions for exogenous treatment set forth in the AFOR Order."

AFOR. Two witnesses presented evidence that addressed the appropriate level of a productivity factor. Dr. William Taylor provided testimony for Verizon and Dr. Marvin Kahn provided testimony for the OPA. Dr. Taylor proposed a productivity factor of 2.0% and Dr Kahn proposed a 6.5% productivity factor including a "stretch" factor. We use the analysis provided by both witnesses to establish a plausible productivity range that serves as a check on the reasonableness of our finding that productivity gains should offset the toll losses that Verizon claims will occur.

Both witnesses addressed the productivity of the telecommunications industry in general rather than that of Verizon Maine. In the first AFOR Order we found that national productivity data is not necessarily relevant to Maine. Both witnesses failed to consider the impact of the cost savings due to Verizon's two recent mergers.[6] They also failed to account for the possibility that the impact of new technologies on Maine's cost structure is likely to be different from that of the nation as a whole. Neither analysis addresses the impact of the write down of Verizon's books that the FCC established as a condition of accepting the proposal put forth by the Coalition for Affordable Local and Long Distance Services (CALLS) for interstate access reform. Finally, both of the productivity analyses address the productivity of the industry as whole and not limited groups of services such as those designated as core services under the first five years of the AFOR.

We find Verizon's witness Dr. Taylor's proposed productivity factor of 2.0 % is understated for many of the same reasons that we stated in the proceeding (Docket No. 94-123) that established the initial phase of the AFOR. Dr. Taylor's analysis and his proposed productivity factor are almost identical to that which he provided in the initial AFOR case.

Dr. Taylor used pre-divestiture total factor productivity (TFP) data that extends back to 1947 to justify his productivity recommendation. In the past two decades, the United States telecommunications industry has undergone some of the greatest technological, market, structural and operational changes in its history. Since the enactment of the 1996 TelAct and widespread use of the Internet, those changes have accelerated. The use of studies that substantially pre-date those events is likely to create results that are not representative of today's telecommunications environment.

For several reasons, we also believe that Dr. Kahn has overstated the productivity of the telecommunications industry. Dr. Kahn included local minutes in his calculation of output, even though increases in local minutes do not result in revenue increases in Maine because of Maine's flat-rated pricing for basic service. Dr. Kahn also adjusted an input price to account for the fact that inputs into the production of

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[6]National productivity studies will recognize some of the productivity gains due to mergers to the extent merging companies are included in the national data. However, since national data include some companies that did not merge, national studies are likely to understate productivity gains by merged companies.

telephone service are likely to be different from inputs to the economy as a whole. He used the average of several years' data to make the adjustment. It is not clear that this adjustment is appropriate when the year-by-year input prices are so volatile. With that volatility, an average is unlikely to reflect any particular input difference. Finally, it is not appropriate to include a "stretch factor" in productivity estimates for a continuing AFOR. A "stretch factor" is designed to account for the increased productivity caused by the initial conversion to incentive regulation.

Set against the high probability that Verizon will be able to achieve continuing productivity gains, and the likelihood that those gains lie between the 2% estimated by Dr. Taylor and the 6% estimated by Dr. Kahn, is the equally high probability that Verizon's toll revenues will decline. Verizon has provided estimates of possible retail toll revenue losses. The estimates have a broad range of $19.8 million to $51 million. The very size of the range indicates substantial uncertainty. Because we expect that continued productivity gains and revenue increases from other services can absorb much of this loss, because the total amount (and the portion attributable to the access parity statute) are so uncertain, and because of other reasons explained below, the revised AFOR will not include any specific additional direct compensation to Verizon for retail toll revenue loss.

As noted above, it is likely that there is a link, albeit indirect, between wholesale access charges and rates in the competitive retail toll market. As access charges are reduced, retail toll rates offered by Verizon's competitors are also likely to decline. In a competitive market, prices tend to follow costs. When the costs for Verizon's competitors fall (as they will when access charges are reduced), those competitors will be able to and likely will reduce their retail toll rates. As one of the competitors in the market, Verizon may have to reduce its rates to meet those of its competitors. After the first round of access reductions that occurred following the 1999 enactment of the access parity statute, the Maine retail toll rates of both Verizon's competitors and of Verizon itself declined. Other competitive circumstances may also influence retail toll rates, however, including the fact that the intrastate toll markets in the various states are linked to the national interstate market through various interstate-intrastate optional calling plans offered by national Interexchange Carriers (IXCs).

If Verizon's retail toll competitors lower their rates, Verizon almost inevitably must lower its rates or risk loss of market share. Nevertheless, Verizon must make strategic pricing decisions based on its informed perception of all competitive markets in which it operates. Particularly under an AFOR, it has every incentive to establish prices that will maximize profits. In the revised AFOR, we are granting Verizon pricing flexibility for almost all non-basic services, including retail toll. Under an AFOR, Verizon should bear the risk of those pricing decisions, just as it will reap the benefits. It may succeed in optimizing profits or it may fail to do so because it misgauges competitive markets. Verizon should not be permitted to make up the difference between optimized revenues and unoptimized revenue levels through an increase to the limited number of rates that remain subject to regulation or through an increase in universal service funding.

It will be impossible, of course, to determine what portion of Verizon's ultimate retail toll revenue loss may be fairly attributed to any effect of the access parity statute, which is out of Verizon's control, and what portion is attributable to pricing decisions and marketing, which are within its control. Accordingly, it is difficult to justify a decision that Verizon should recover some specified portion of the toll revenue loss that may occur in the next few years.

Changes in market share are likely to affect retail toll revenues , either positively or negatively. We see no link, however, even an indirect one, between the access rates (required by statute) that may affect competitive retail toll rates and Verizon's retail toll market share. Retail toll market share can, of course, significantly effect retail toll revenues. The success that Verizon may or may not have in retaining (or even regaining) retail customers might significantly affect its revenues. Through strategic pricing decisions and marketing, Verizon has considerable influence over its share of the retail market. Access costs may affect overall rates in the intrastate retail market, but once that influence has been established, each competitor's market share is established by its own pricing decisions (relative to other prices in the market), brand recognition and other marketing efforts.

We recognize that much of what we say concerning market share of retail toll also applies to access, though inversely: assuming that total intrastate toll usage remains constant, gains by Verizon in toll mean losses in access and vice versa. Thus it is impossible, in advance, to estimate how much revenue Verizon will lose as a result of the access reduction when the toll effects are taken into account. Taking the evidence as a whole, however, we conclude that the access reduction will produce a revenue loss of at least $12.5 million (which we have allowed Verizon to recover through higher basic rates), and that the additional profits that Verizon will lose due to falling toll prices (and/or a smaller share of the toll market) will be matched – not exactly but conceptually within the AFOR framework – by increased productivity and other sources of revenue. We thus decline to provide a safety net to Verizon for every dollar that it lose from retail toll.

As discussed above, the amount of ultimate retail toll revenue loss is quite speculative at this point; the timing is also in doubt. We do believe, however, that there should be some guarantee that there is in fact a reduction in retail toll revenues and/or rates, i.e., that access rate reductions are flowed through to retail toll customers, particularly since retail customers will be paying for the access rate reductions through an increase to their basic rates. We will require Verizon to prove that retail customers receive the benefit of the access reductions by at least the amount represented by the low end of Verizon's estimated toll revenue loss. That amount is $19.8 million.[7]

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[7]The Part One Order in this case (May 9, 2001) mistakenly stated that Verizon's low estimate was $19 million.

Wholly apart from the obligation we have to demonstrate to consumers that, on balance, the increases to basic rates will be accompanied by reductions in rates consumers pay for toll services, our requirement that Verizon show that consumers have benefited in fact (and not just theory) by $19.8 million is warranted to ensure the integrity of our process. Verizon claimed that it would lose *at least* $19.8 million annually in toll revenues as a result of the access reduction. We have relied on that representation both in allowing Verizon to increase basic rates to recover 100% of the expected *access* lost revenue, and in declining to impose a specific productivity offset that would be likely, in periods of low inflation, to force specific *decreases* in Verizon's rates. If Verizon's estimate is correct, and toll revenues or rates will fall *at least* $19.8 million, Verizon will have no difficulty meeting the condition we impose here. If, on the other hand, Verizon's estimate was merely a litigation posture, and it does not "really" expect that reduction, Verizon cannot now complain that the Commission has taken it at its word; it should bear the financial consequences of its litigation strategy.

The Company may comply with this requirement by showing that either its retail toll revenues or its retail toll rates have declined by at least $19.8 million. If Verizon decides to show that its toll revenues have declined, it shall use the 12 months that ended on May 31, 2001 as the base period. The Company must show that its actual recorded retail toll revenues for the 12-month period ending on May 31, 2003 are lower than those in the base period by $19.8 million. We allow Verizon to use the second full year following the implementation of the revised AFOR (and the access rate reductions that went into effect on May 30, 2001) so that access rate and any toll rate reductions will have their full effect on toll revenues. Verizon must compare its total intrastate toll revenues for the base period to the future period to show that its actual recorded revenue declined by at least $19.8 million.

If the Company decides to make the required showing that its retail toll rates have declined by $19.8 million it shall compare the rates that are in effect on May 31, 2002 with those that are in effect on May 31, 2001. For the purpose of weighting the rates in effect at those two points in time, the Company shall use billing units for the 12 months ending May 31, 2001. This method is essentially the same as that used during the first five years of the AFOR for establishing that proposed rate changes satisfied rate change requirements under the PRI formula. This rate comparison alternative allows Verizon to disregard its actual toll revenue level and concentrate on increasing or retaining its toll revenue through pricing decisions and marketing that might result in increases in sales volumes (billing units) or in market share.

Verizon must make a filing by July 31, 2003 that demonstrates that it has met one of the two alternatives. If it chooses the rate reduction option, it must show that its retail toll rates in effect on May 31, 2002 were $19.8 million lower than those in effect on May 31, 2001. If Verizon chooses the revenue option, it must make a filing showing that its revenues for the period June 1, 2002 to May 31, 2003 were at least $19.8 million less than its retail toll revenues for the period June 1, 2000 to May 31, 2001. If Verizon has not achieved a retail toll revenue reduction of at least $19.8 million by May 31, 2003, it must file rate reductions (for toll or other services) that will have the effect of reducing revenues by the amount of the difference between $19.8 million and the actual achieved amount of revenue reduction, based on the billing units for the 12-month period ending May 31, 2001.[8]

One of the central characteristics of incentive regulation is that a utility bears the impact of high and low earnings due to a variety of causes, including competitive market forces. In the first AFOR Order, we rejected arguments that we should impose caps on over-earnings and under-earnings. In the revised AFOR, Verizon will have a substantially greater amount of pricing flexibility than it had during the first five years of the AFOR. We expect that Verizon will bear the risks and reap the rewards of the market. Our finding and decision that Verizon should be able to absorb reductions in toll revenue through productivity gains provides a considerable incentive for Verizon to undertake every reasonable effort to produce such productivity gains. Verizon should not expect during the AFOR to request “relief “ for toll revenue losses that exceed its estimates. Any such action would be antithetical to an AFOR incentive plan.

VI. OPERATOR SERVICES AND DIRECTORY ASSISTANCE

In the FNOI, we suggested that the markets for directory assistance (DA) and operator services were not sufficiently competitive to allow Verizon pricing flexibility for its provision of these services. Verizon has argued that those markets are competitive and that we should allow pricing flexibility. We decide that the services will remain subject to direct price regulation.

Operator services are services that require the assistance of a live operator, or a mechanized equivalent, that obtains billing data from the caller when a call is not or cannot be billed to the line used for originating the call. The most familiar mechanized equivalent is the “bong tone” that signals to a caller to enter a calling card number. Other types of calls that require operator assistance include calls billed to a third party and collect calls.

Directory assistance provides phone numbers to callers who do not have access to printed or electronic directories, who are unable or unwilling to use an accessible directory, or who request numbers for new listings not included in any directory.

These services are offered by both local exchange carriers and interexchange carriers. Verizon provides both local and interexchange telephone service and is a major provider of both directory and operator services. The other major providers of directory and operator services are interexchange carriers such as AT&T, MCI WorldCom and Sprint. Operator services are used almost exclusively in connection with long-distance (toll) calls. Directory assistance is provided in conjunction with both

[8]We recognize that there may be ways to try to game this alternative, but we trust that Verizon will act in good faith. Needless to say, if the Commission found a rate reduction only technically complied with this condition, but otherwise did not meet its spirit, it would find it was not in compliance with this Order.

local and long-distance services. Most callers have access to local directories, but the telephone numbers of new customers who move into a local calling area will not be included until the directory is republished. Callers generally have less access to directories for locations outside their local calling areas.

The providers of DA and operator services charge a fee for each use of the services. Those fees are in addition to any toll or other charge that applies to the call that the caller makes in conjunction with using the service.

Little evidence has been presented about this issue. Verizon's evidence and argument consist of conclusory statements that there are multiple providers of operator and directory assistance services, including the availability of some directory assistance information on the Internet. Verizon has not shown that there is price competition for these services. The Public Advocate provided no evidence or argument on these issues beyond the argument that a core nondiscretionary category (presumably including operator services and DA) should still exist and be price-capped.

During the five and a half years of the current AFOR, Verizon's rates for directory assistance and operator services have remained capped at the levels that existed immediately prior to the AFOR. In the Order establishing the first AFOR, we found, without extensive discussion, that these rates were "core nondiscretionary," meaning that we considered them to be "essential" rather than "nonessential" services and that they could not be increased unless the PRI (the overall price cap) was positive.[9] In many cases it is not possible to make a phone call without using an operator service and/or DA. In this sense, DA and operator service calls are more "integral" to basic service than other "optional" services; customers using these services may legitimately expect a greater degree of regulatory price oversight until robust price competition emerges.

Nothing has changed during the course of the AFOR that makes these services any less essential. Although there may be more DA providers than previously, there is some concern that their listings are incomplete and inaccurate.[10] In this proceeding, Verizon has made no claim that either of the services is priced below cost. Indeed, the increasing mechanization of these services indicates that costs might be declining.

[9]The PRI was negative in all five years of the AFOR.

[10]The FCC, in CC Docket No. 99-273 (January 27, 2001), has required ILECs to make their DA databases available to competitors (including both IXCs and Internet DA providers) at nondiscrimatory and reasonable rates because of concerns about the accuracy of competitors' databases and because ILECs derive their more accurate databases from their service ordering processes. The FCC's purpose in ordering this access was to promote a competitive market for DA services. It found that competing providers have had difficulty offering a competitive product.

We take notice (through rates on file with the Commission) of the fact that virtually all of Verizon's "competitors" for operator and directory assistance services charge substantially more than Verizon. For example, Verizon's surcharge for using a calling card is 58 cents. Although some subscribers to long distance calling plans offered by AT&T, MCI WorldCom and Sprint may receive somewhat lower charges, calling card charges for other users are from $2.25 for MCI to $3.95 for Sprint.[11] In addition, those carriers appear to charge higher per-minute toll rates for operator-assisted calls than for 1+ calls.

For collect calls, the surcharges of AT&T, MCI WorldCom, and Sprint range from $2.25 to $3.95. Verizon's surcharge for a collect call is $1.30.

For directory assistance, the charges imposed by AT&T, MCI WorldCom, and Sprint for casual users range from $.80 to $.95. Verizon's charge is 40 cents for each request (after an allowance of three free requests per month).[12]

During the initial phase of the AFOR, all three of these competitive interexchange carriers have consistently raised their operator service and directory assistance rates.

Although there are other suppliers of these services, it appears that there is no *effective* price competition. As of 1999, Verizon's market share (based on revenues) of the Maine intrastate retail toll market was about 55%. As noted above, operator services are used primarily in conjunction with toll calling and DA is used in conjunction with both local and toll calling. Verizon provides the vast majority of local exchange service within its service territory, and given its large shares of both the toll and local exchange markets, one might expect that Verizon would be a price leader in associated markets, and that other providers would attempt to compete with Verizon's prices. In fact, as discussed above, other providers continue to have substantially higher charges than Verizon's and continue to increase those changes.

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[11] AT&T charges a $2.25 rate for callers who use a non-AT&T calling card, but $1.25 to callers who use a calling card issued by AT&T. However, if a caller accesses AT&T's network by means other than by 10+10+288 or 1-800-CALLATT and uses a card issued by a carrier other than AT&T, the surcharge is $4.95.

[12] The Commission required 10 free requests in *New England Telephone and Telegraph Company, Re: Proposed Increase in Rates,* F.C. #2213, Order (June 10, 1977). Prior to that case, New England Telephone had provided directory assistance without charge. The Company argued that a small number of customers made most of the directory assistance calls and that about half of DA calls were made for numbers that were published in the caller's local directory. The Company proposed a charge to deter excessive use of the system and to recover its costs from those who used the system. The Commission required the Company upon request to provide free directories for any location within 30 miles of the customer's home exchange. Subsequent cases gradually reduced the free call allowance to three.

The manner in which customers purchase DA and operator services contributes to our conclusion that we should not yet remove price constraints. Telephone callers can reach carriers other than the one to which the line is presubscribed through "dial-around" (using a 101XXXX code, a 950XXXX number, or an 800 number). Nevertheless, a caller who attempts to place a 0+ call (to use a calling card or to place another type of call requiring an operator service) without "dialing around" will obtain the operator service from the company to which the telephone line (including a pay phone) is presubscribed.

In contrast to operator services, a customer who calls DA service will obtain the DA service provided by the customer's local exchange carrier. In Maine, that service will be provided by Verizon (whether the customer calls 411, 555-1212 or 1-207-555-1212), unless the customer has subscribed to a competitive local exchange carrier (CLEC) or "dials around" to reach a DA service provided by an interexchange carrier using the carrier's 101XXXX code, 950XXXX, or 800 number, then dialing Area Code + 555-1212. (In most cases, the caller must also dial a billing number, (e.g., a calling card). A caller may obtain Verizon DA by dialing 411; from a line that is prescribed to another carrier, calling 411 is a form of dial-around.

Because of the difficulty of dialing around, we doubt that most consumers will dial around for alternative DA and operator services, even if they knew the prices of alternative providers. Some carriers effectively discourage shopping around by callers that do not have a calling card issued by that carrier. As noted above, AT&T charges $2.25 for using a non-AT&T calling card while it charges $1.25 per charge for a customer that does use an AT&T card.

Because of the extremely small penetration levels by CLECs, almost all persons who call DA service will obtain the service provided by Verizon unless they go through the cumbersome dial around process. At present, at least in part because of regulation of intrastate DA rates, dialing around has no benefit. Verizon DA users will obtain much more favorable rates by not dialing around. The fact that Verizon has a virtual monopoly on DA service (even if it presently acts as a benevolent monopolist) is nevertheless a strong reason for continued regulation.

We place little weight on Verizon's claim that the Internet offers alternative DA services. Not everybody is connected to the Internet. Moreover, the FCC has expressed concerns about the accuracy of DA information from IXC and Internet providers. Persons who are traveling constitute a substantial portion of users of DA services; those persons are far less likely to have access to the Internet than persons who are at their home or workplace, particularly when they are at a pay phone. It is doubtful that the Internet offers any operator services because, at present, persons who use the Internet to make long-distance calls do so for "free," i.e., without per-minute charges.

We find that DA and operator services are essential, at least for the completion of many calls, and that effective price competition for these services has not yet emerged.

We will therefore not allow Verizon to establish prices without direct regulatory oversight. Verizon's prices for these services will be capped, unless, during the course of the AFOR, it makes a showing that increases or pricing freedom should be allowed. We recognize that the prices for these services have been in effect now for more than five and a half years. If Verizon proposes to change any of these prices, however, it will need to prove that its proposed price changes are cost-justified. We will also consider a request to allow greater pricing flexibility if Verizon can show that a truly competitive market has developed for either of these services.

VII. SERVICE QUALITY

A. Introduction

The Commission included a Service Quality Index (SQI) in the first phase of the AFOR with performance baselines and financial penalties, first to meet our service quality goals for telecommunications,[13] and second to provide Verizon Maine (then NYNEX) with strong financial incentives not to cut its costs at the expense of service quality. Because we believe the SQI has proven effective during the first five years of the AFOR, we continue the mechanism but adopt modifications to the SQI in the revised AFOR.

B. Positions of the Parties

1. Verizon Maine

Verizon Maine argues that a Service Quality Index (SQI) is unnecessary in a revised AFOR because Verizon Maine's service quality was good before the AFOR, it has been good during the AFOR, and it would have been good without the AFOR's SQI; and competition has increased under the AFOR, is bound to continue increasing as time goes on, and because service quality is an important feature as customers choose among competitive service providers, maintaining good service quality is critical to Verizon's success in the competitive marketplace.

Moreover, Verizon alleges, the terms of the Bell Atlantic-GTE merger are effective in ensuring quality. Under the merger terms, Verizon reports monthly service quality data for each state to the FCC in accordance with the criteria in the NARUC "Service Quality White Paper" (the reports are available from both the FCC and Verizon websites), and Verizon Maine has committed to the "Service Quality Assurance Plan," which includes better customer communication on installation appointments, better network monitoring and response to network congestion, an

[13] Those goals are to "ensure" that telecommunications service quality, reliability, customer treatment, and credit, collection, and sales practices (including possibly anti-competitive activities), receive adequate regulatory consideration and protection; and maintain adequate quality of service standards and reporting requirements so that achievement of goals can be evaluated." Docket No. 94-123 Notice at 4.

“ombudsman” position focused exclusively on Maine service issues, and quarterly meetings with the Commission and Staff to review service results.

Further, Verizon argues that in a competitive marketplace, the administrative and financial burden of imposing an SQI with a rebate mechanism *only* on Verizon Maine would be inequitable. If the Commission determines service quality reporting is necessary in a revised AFOR, the reporting should be based on industry-wide baseline performance levels and be required of all carriers.

Finally, Verizon maintains that the current SQI has proven successful in preventing “the systematic and wide-spread deterioration of service quality” feared by the Commission under incentive regulation. Therefore, if the Commission determines an SQI is necessary in the revised AFOR, it should continue the current SQI unchanged.

2. The Office of the Public Advocate

The OPA argues that an SQI is necessary in a revised AFOR because, although service quality is an important characteristic for choosing service providers in a competitive market, Verizon Maine has virtually no competition in the residential local exchange market. It further argues that Verizon Maine is such a small portion of the revenues from Verizon’s 13-state footprint that the resources necessary to assure good service quality could disappear without an SQI.

The Public Advocate also claims that most competitors will not duplicate Verizon Maine’s network but will rely on Verizon Maine’s service quality to provide services to customers in Maine; thus, Verizon Maine’s service quality will be critical even if a customer takes local exchange service from a CLEC, and that only Verizon Maine has the duties and obligations associated with its role as the incumbent provider of local exchange service for the vast majority of Maine’s households and businesses; yet there are no specific service quality standards that are applicable to Verizon Maine except for those that exist in the SQI. Further, it argues that if the revised AFOR is, like the initial phase of the AFOR, a multi-year plan, there will be no regular rate cases to trigger service quality reviews and responses.

Finally, OPA argues that the data Verizon reports to the FCC pursuant to the NARUC Service Quality White Paper provides no performance baselines and therefore no basis for tracking comparative performance over time and no penalties or customer rebates for deterioration in performance.

The OPA would not oppose Verizon’s position that the Commission should require service quality reporting not just by Verizon Maine but by all LECs and CLECs. Minimum service quality standards applicable to *all* carriers, however, would not necessarily reflect Verizon Maine’s historical performance and might instead allow a lower level of performance by Verizon Maine, because of the tendency of generic rules to apply the “lowest common denominator” as the minimum performance standard.

Such generic service quality reporting would be no substitute for a SQI with performance baselines that reflect Verizon Maine's performance.

The OPA argues that the original SQI should be changed in the following areas: the baseline performance levels and how performance is measured, for some metrics; added performance metrics and baseline levels; and the rebate structure, to account for the number of proposed metrics and Verizon Maine's current revenues.[14]

C. Generic Topics Raised in the FNOI

1. General Description of Topics

The FNOI asked for comments on a number of generic topics discussed in connection with the proposed SQI: more "granular" reporting, such as by wire center; separate reporting for residential and business customers; separate reporting for urban and rural areas; using "surveillance" levels; how performance baselines should be set; how any customer rebate mechanism should be structured; and whether to include carrier-to-carrier wholesale service quality performance metrics. We discuss the parties' responses below.

2. SQI Reporting by Wire Center vs Service Territory-Wide

Both Verizon and the OPA expressed concerns about the burden, costs, complexity – and for Verizon also the necessity – of wire center-based reporting for the SQI. Verizon states that it lacks historical wire center data for many of the metrics in the SQI that was proposed in the FNOI, and that it would be an extremely cumbersome, time-consuming, and expensive manual effort to report wire center-based data for metrics for which historical data are available.

3. Separate Reporting for Residential and Business Customers

The OPA supports separate reporting for residential and business customers, claiming that historical data would show Verizon Maine performing at a higher level for business customers for most SQI metrics and that such gaps should be closed over time so as to provide residential customers the same quality of service it provides business customers. Verizon Maine states it has historical data for each customer class (from which baseline performance levels could be calculated) for several SQI metrics, but generally opposes expanding the SQI reporting beyond the levels in the current SQI. Verizon Maine points out that its reports to the FCC pursuant to the NARUC White Paper's service quality criteria include separate reporting for residential and business customers, and that the Commission will be able to monitor Verizon Maine's performance by customer class with those reports.

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[14]The OPA's proposed SQI is described below in Section VII. D.2.

4. Separate Reporting for Urban and Rural Areas

Verizon Maine's position on this issue is the same as its position on separate reporting for residential and business customers. The OPA did not comment on this issue.

5. Service Quality "Surveillance" Levels

NARUC's Model Telecommunications Service Rules include the concept of "surveillance" levels, which appear to be about 20% less stringent than the SQI baseline performance levels. Under these rules, if a carrier fails to meet a performance metric's surveillance level for three consecutive months, it must investigate, take corrective action, and report the results to the Commission. The FNOI asked whether some or all of a revised SQI's metrics should incorporate surveillance levels.

The OPA is opposed to using the surveillance levels' "two-tiered" approach; it argues that the lowest performance level would become the focus of attention and enforcement and, therefore, the only standard that has regulatory significance. Using a single standard – such as the SQI's baseline performance level – avoids confusion about the Commission's expectations and the public's understanding of what Verizon Maine must achieve to avoid paying customer rebates.

Verizon Maine is also opposed to an SQI that incorporates surveillance levels, because they would cause an additional, burdensome layer of administrative reporting and substitute lower thresholds for customer rebates than those set by the SQI's baseline performance levels. Verizon Maine stated that it could support surveillance levels if the Commission changed the SQI's reporting structure to "exception reporting" (i.e., reporting only service results that are worse than the defined performance level), whereby the Commission could require reporting of any SQI metric for which the monthly results fell below its surveillance level for three consecutive months. Verizon Maine suggests such an arrangement would reduce the administration burden of monthly service quality reporting for both itself and the Commission.

6. How SQI Baseline Performance Levels Should be Set

In the prior AFOR proceeding, we considered how to reflect the year-to-year variability in Verizon Maine's (then NYNEX's) performance, as measured by the SQI's metrics, in setting performance baselines. Ultimately we accounted for that variability by setting the SQI's performance baselines at Verizon Maine's worst annual performance in each of the three years prior to the AFOR order, i.e., 1992-1993 through 1994-1995.

For the SQI in the revised AFOR, Verizon Maine supports the method the Commission used: it states that the baselines were set so as to assure that service levels under the AFOR would not deteriorate below the levels achieved under rate of return regulation, that any revised SQI should be based on that same rationale, and therefore in a revised SQI no changes should be made to the original SQI's performance baselines. The OPA states that performance baselines should reflect Verizon Maine's historical performance and be based on a review of the degree of variability in it and any trends in recent performance.

7. How a Customer Rebate Mechanism Should be Structured

Verizon Maine states that in a competitive market, in which customers who are dissatisfied with a carrier's service quality will simply take their business elsewhere, the Commission must exercise caution when it imposes service quality standards and penalties on any single carrier. The market should be allowed to develop all conceivable service options if there is customer interest, without hindrance from Commission-imposed service reporting standards. If the Commission concludes that service quality reporting and penalties continue to be required to maintain service quality, Verizon Maine opposes any increases in penalties, or shifts in the distribution of penalties among SQI metrics, or changes in how rebates to customers are distributed, because such changes would only add to its overall administrative compliance costs, which ultimately must be borne by its subscribers.

The OPA recommends no change in the basic structure of the existing customer rebate mechanism. It recommends increasing the maximum rebate amount at risk to reflect Verizon Maine's current revenues, however, so as to provide the same incentive to Verizon's management not to cut costs at the expense of service quality in the second phase of the AFOR as the maximum rebate amount did in the initial phase. Otherwise, the OPA argues, Verizon Maine might conclude that the payment of penalty dollars is "worth" a certain amount of deterioration in service quality. The OPA recommends the maximum rebate amount be set at 4.5% of jurisdictional retail revenues.

8. Service Quality to CLECs: "Carrier-to-Carrier" Service Quality Performance Metrics

Because the development of local exchange competition was an important aspect of the AFOR revisions proposed in the FNOI, the Commission asked parties to comment on whether a revised SQI should incorporate metrics that measure the quality of Verizon Maine's services to CLECs. Verizon Maine recommends that the Commission not add such metrics to a revised SQI but instead develop them as part of its Section 271 proceeding that the Commission will conduct.[15] The OPA makes the same recommendation, and, in particular, recommends that the Commission use the same performance metrics the FCC imposed as a condition of its approval of the Bell Atlantic-GTE merger.

[15]Under 47 U.S.C. § 271 the Commission must "consult" with the Federal Communications Commission concerning whether Verizon should be permitted to provide interLATA service in Maine.

D. SQIs Recommended by the Parties

1. Verizon Maine's SQI Recommendations

Verizon Maine contends that Maine's telecommunications market has become competitive, that competition will increase, and that because service quality is such an important factor in choosing a service provider in a competitive market that competition will discipline carriers' service quality. The Commission therefore should allow the market, rather than an SQI's metrics, to determine which service characteristics customers care most about and carriers should therefore concentrate on. Thus, Verizon Maine contends an SQI is unnecessary. Verizon Maine further contends that in a competitive market any service quality reporting the Commission considers necessary should be imposed not just on Verizon Maine but also on all its competitors.

If the Commission decides an SQI continues to be necessary to maintain its service quality, Verizon Maine recommends that at most the Commission retain the current SQI, its performance baselines, customer rebate mechanism, and maximum and per-metric rebate amounts, unchanged.

The original SQI had 12 performance metrics. (See Table 1).

TABLE 1
Current Verizon Maine SQI

PERFORMANCE METRICS	BASELINES
<u>CUSTOMER SERVICE</u>	
Installation - % Appointments Not Met on Time – Co Reasons	1.65
Held Orders Average Total Delay Days	2051
Business Office calls % Answered over 20 seconds	31
<u>SERVICE RELIABILITY</u>	
Customer Trouble Reports Rate per 100 lines – Network	1.08
% Troubles not cleared within 24 hrs – Residence	21.1
% Troubles not cleared within 24 hrs – Business	9.0
Dial Tone Speed % over 3 seconds	0.36
Major Service Outage	977
<u>CUSTOMER SATISFACTION (% ALMOST MET/FAILED EXPECTATIONS)</u>	
TELSAM Residence Provisioning	7
TELSAM Small Business Provisioning	11
TELSAM Residence Maintenance	14
TELSAM Small Business Maintenance	15

2. OPA SQI Recommendations

The OPA proposes an SQI with 20 metrics grouped into the same three service categories as in the original SQI. It would include 10 new metrics and 10 metrics from the initial phase of the AFOR. Of the metrics from the original SQI, eight would be unchanged, and the performance baseline of two would change. The OPA's proposed SQI also includes two additional metrics without performance baselines, which the Commission could consider adding when sufficient historical data is available to calculate performance baselines. (See Table 2.)

TABLE 2

SQI PROPOSED BY THE OPA FOR VERISON-MAINE

PERFORMANCE METRIC	BASELINE
(N) = new metric	(C) = changed baseline
CUSTOMER SERVICE	
(1) Installation Appts. Not Met (Co. reasons)-Res.	1.65%
Repair Appts. Not Met (Co. reasons)-Res.	Report Only*
(2) Installation Orders Held-Res. And Bus.	
(N) Missed Installation Rate	.67
(N) Average Delay Days Installation Held Orders	6.14
(3) Answer Time Performance	
(C) Business Office: % Ans. >20 sec.	25%
(N) Repair Center Calls: % Ans. > 20 sec.	25%
(N) Repair Center Busy Rate	3%
RELIABILITY OF SERVICE	
(4) Percent Troubles Not Cleared w/I 24 hrs.-Bus.	21.1%
(5) Percent Troubles Not Cleared w/I 24 hrs.-Res.	9.0%
(6) Customer Trouble Report Rate per 100 lines	1.08
(7) Network Congestion	
(C) Dial Tone Speed: % over 3 sec.	.1%
(N) Host/remote clusters > .36% delay	0
(N) Umbilical Blockage, units >.11% blocking	Report Only*
(8) Service Reliability	
(N) Service Outage (5,000 lines > 30 min)	0
(N) Interoffice Fiber Failure (30,000 lines > 30 min)	0
(N) SS7 Failure (>30 min.)	1
<u>CUSTOMER SATISFACTION (% almost met/failed expectations)</u>	
(9) Provisioning	
CCI Residence Provisioning	7
CCI Sm. Bus. Provisioning	11
(10) Maintenance	
CCI Residence Maintenance	14
CCI Sm. Bus. Maintenance	15
(11) (N) PUC Complaint Ratio	0.6

* The OPA recommends the Commission evaluate this data after two years and then decide whether to add these performance areas to the SQI with a performance baseline that reflects Verizon Maine's performance. If these items are added, the OPA recommends appropriate changes be made to the penalty structure, including an increase in the total penalty dollars at risk.

3. New Metrics Proposed By OPA

a. Repair Appointments Not Met for Company Reasons

Verizon Maine's repair performance was measured in the original SQI by the "Troubles not cleared within 24" hours metrics for business and residential customers. The OPA points out, however, that the percentage of repair appointments missed for Company reasons is much higher than for installation appointments missed, averaging seven to eight times higher over the last three years.

b. Held Orders

The OPA proposes to replace the "Held Order" metric in the original SQI with two new metrics: "Missed Installation Rate" and "Average Delay Days Installation Held Orders." The first is the percentage of installation appointments missed for Company reasons; the second is the number of "delay days" between the promised installation appointment date and the date of the completed installation, averaged over all customers with orders delayed for Company reasons. The OPA believes these metrics do a better job than the original SQI metric in measuring the delays customers actually experience in waiting for basic service to be installed.

c. Answer Time Performance[16]

Repair Center Calls: percent answered in greater than 20 seconds, and Repair Center Busy Rate. This area of performance was not measured in the original SQI. The OPA believes customers deserve the same call answering performance for reporting service troubles as they get calling Verizon Maine's business office.

The OPA recommended a 25% call answering baseline, based on its assessment of Verizon Maine's recent performance. Its recommended 3% Busy Rate baseline is based on a standard included in a stipulation that Verizon-Vermont joined in Vermont and OPA's assessment of the rate in place at the federal level for calls to cable TV operators.

d. Network Congestion

Host/remote cluster – dial tone speed: percent over 3 seconds; and Umbilical Blockage. The OPA proposed the dial tone speed (DTS) metric be applied to each of Verizon Maine's 14 host/remote switch clusters. The OPA-

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[16]The OPA appears to recommend that this metric and the Held Order metrics be reported separately for residential and business customers (which if so would make a total of 25 metrics in its proposed SQI). The Examiner's Report requested clarification from the OPA on these points, but none was provided in its exceptions.

recommended 0.36% baseline is the DTS baseline in the current SQI, which is the DTS averaged over all Verizon Maine's central office switching machines.

The Umbilical Blockage metric measures the percentage of calls blocked when all trunks are in use that connect remote switches to their host switches. The original SQI did not measure call blocking, which, along with delayed (or no) dial tone, occurs when a telephone network is congested.

e. Service Reliability

Service Outage (5,000 lines > 30 minutes); SS7 network failure (>30 minutes); and interoffice fiber failure (30,000 lines > 30 minutes). These outages were measured by the Service Outage metric in the original SQI, but the OPA believes it is inadequate, arguing that the present baseline is not a strict enough standard and thereby allows Verizon Maine's reliability to deteriorate without penalty. For these three new metrics, the OPA's recommended baselines (0; 0; and 1, respectively) and penalty amounts [$250,000; $250,000; $500,000 (> 30 minutes); $1,600,000 (> 60 minutes), respectively] are based on standards to which Verizon stipulated in Vermont.

f. PUC Complaint Ratio

This metric measures the number of complaints made by Verizon Maine's customers to the Commission's Consumer Assistance Division. The ratio is the number of complaints filed per 1,000 utility company customers. These are complaints that customers have already discussed with Verizon Maine, but its response did not satisfy the customers.

The OPA bases the inclusion of this metric on a recent surge in disconnection-related complaints that were attributed to Verizon-New England when Verizon consolidated some Verizon Maine-based customer service operations with operations in Massachusetts. The OPA's recommended baseline (0.6) is based on its assessment of 1997-1999 complaint statistics.

4. Changed OPA Metrics

Dial tone delay: percent over 3 seconds, and Business Office: percent of calls answered in over 20 seconds. The OPA-recommended baselines (0.1% for dial tone delay and 25% for call answering performance) are based on its assessments of Verizon Maine's recent performance.

5. Other OPA Service Quality Recommendations

a. Customer Rebate Dollar Amount

The OPA recommended the total dollars at risk in the SQI be raised to $16 million, from the current $11 million. This recommendation is based on Verizon Maine's current revenues and the fact that Verizon Maine is a much smaller part of a much bigger company.

b. Customer Notification of Service Quality

The OPA recommended the Commission continue the provision in the initial phase of the AFOR that requires Verizon Maine to inform customers that a service quality penalty has occurred. The OPA also recommended that the revised AFOR include an annual service quality report to be sent by Verizon Maine to its customers, so they will be informed of Verizon Maine's performance in all service quality areas the Commission is monitoring.

c. Customer Rebates for Specific Failures

The OPA points out Verizon Maine's tariffs provide rebates to customers when local service and other services are interrupted beyond specific lengths of time, but that customers must apply to Verizon Maine for the rebates and do so within ten days. The OPA recommends that the Commission end the application requirement and order Verizon Maine to make the rebates automatic and to periodically inform customers that such rebates exist.

d. Other OPA Recommendations

The OPA also recommends that the revised AFOR include rebates when Verizon Maine fails to keep appointments or fails to install service on the date promised. The OPA recommends the rebate be a fixed amount or a waiver of certain charges. In addition to requiring Verizon Maine to act like a company subject to competition, the OPA suggests such rebates will help ensure against localized service quality failures that would not show up in the SQI's service territory-wide averaging.

E. The Revised SQI

We will include a Service Quality Index in the revised AFOR for the same reasons we included the SQI in the current AFOR, and for the following additional reasons. First, under the structure and pricing rules of the revised AFOR, only Verizon Maine's rates for basic exchange service for residential and small business customers, directory assistance and operator services are capped; Verizon Maine has pricing flexibility for all other retail services. The revised AFOR therefore represents a substantial reduction in the regulation of Verizon Maine's operations compared to the current AFOR. Second, there is insufficient local exchange competition in Verizon

Maine's service territory – and virtually none for its residential and small business customers – for the Commission to rely on competition alone to cause Verizon Maine to maintain and improve its service quality. Third, as the OPA has pointed out in this proceeding, most CLECs in Maine rely in whole or in part on the quality of Verizon Maine's services and facilities to provide local exchange service to their customers. Fourth, we believe Verizon Maine, as a small fraction of its parent company, will need the monetary rebate mechanism of an SQI to command the attention of Verizon management.

We reject Verizon Maine's position that Maine's local exchange market is, or soon will be, competitive enough for customers dissatisfied with its service quality to simply take their business elsewhere. The testimonies of OPA witnesses Norton and Sweet establish that CLECs provide virtually no competitive alternatives for residential and small business customers.[17]

As we noted in the FNOI, Verizon Maine's service quality during the AFOR has generally been good. Verizon Maine may well be correct that its service quality also would have been good without the SQI and its rebate mechanism. We agree with Verizon Maine's position that, in a competitive market for local exchange service, competition should be sufficient to discipline the carriers' service quality, and we agree that in such a market all carriers, not just Verizon Maine, should be required to comply with any service quality reporting the Commission decides is necessary. But Maine does not yet have a competitive local exchange market; the record in this case shows that Verizon Maine dominates the market in its service territory. Thus, we agree with the OPA. For the foreseeable future, only Verizon Maine has and will have the duties and obligations associated with being the only provider of local exchange service for the vast majority of Maine's homes and businesses, and there are no specific service quality standards that are applicable to Verizon Maine – except those that exist in an SQI.

In the FNOI, we asked the parties to consider a number of refinements and additions to the current SQI, including separate reporting for urban and rural regions and for residential and business customers, and especially reporting certain metrics by wire center, rather than the service territory-wide reporting that is averaged over all 140 Verizon Maine wire centers. Averaging has a well-known "smoothing" effect, which can mask both extremely good and extremely bad service results; from the standpoint of the SQI's role in monitoring Verizon Maine's service quality we are more concerned with bad service results going undetected. The original SQI, for example, did not detect the instances – i.e., the specific wire centers – in 1999 and possibly earlier, where customers suffered the effects of significant congestion in access line termination units and umbilical trunks. The original SQI did not have a call blocking metric. The Commission learned of the congestion from customer complaints to the

[17] Verizon Maine provides about 85% of the access lines in the whole State; most of the rest are provided by independent ILECs in their own separate service areas. It follows that Verizon Maine provides a far higher percentage of access lines within its own service territory.

Consumer Assistance Division, which prompted our investigation into Verizon Maine's network management and monitoring practices in Docket No. 99-132.

The parties' comments on the SQI revisions suggested in the FNOI have been valuable. They have reminded us that the original SQI was designed to prevent systematic and widespread deterioration in Verizon Maine's service quality under the AFOR; we believe the SQI has succeeded in doing so. We agree with Verizon Maine that revisions to the SQI should not make it more complex, burdensome, and costly for the Company to function. With respect to the generic topics on which the FNOI requested the parties' comments, the revised SQI will not require separate urban-rural reporting, or additional separate residential-business customer reporting; it will not expand wire center-based reporting; it will not include "surveillance" performance levels or carrier-to-carrier (Verizon Maine-to-CLEC) wholesale service quality performance metrics. The revised SQI will retain the original SQI's baselines for existing metrics (the worst of the three years in the baseline period) and revise the method for establishing new baselines (the average of the last three years).[18] It will retain the customer rebate mechanism from the first phase of the AFOR, but will increase the maximum and per-metric rebate amounts.

We will study Verizon Maine's service quality reporting to the FCC to see if its residential-business and urban-rural performance results are significantly different. If they are, we will consider modifying the SQI. As for wire center-based reporting, we will require Verizon Maine to continue the network congestion reporting we ordered in Docket No. 99-132. The terminating and originating call blocking reports may be reduced to an "exception report" format, and all reports should use the Company's actual internal standard call blocking thresholds for line units, umbilicals, and trunks. We will require the Company to add "busy hour call blocking in switch module links" to its congestion reports.

1. <u>The OPA's Recommended SQI</u>

We will adopt the OPA's recommended Average Held Order Delay Days, Report Center Call Answering, and Repair Appointments Not Met metrics. These are metrics we also suggested in the FNOI. We will adopt the call blocking metric suggested in the FNOI, which will include the OPA's recommended "Umbilical Blockage" metric, but will also include the other sources of call blocking – line units, interoffice trunks, and switch module links.

We do not believe the OPA's Missed Installation Rate metric is necessary, as it overlaps the existing "Installation Appointments Not Met" metric.

We also do not believe it is necessary to add the OPA's recommended new Repair Busy Rate metric to the SQI. There is no evidence that

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[18]As the parties recommended, we will take up carrier-to-carrier metrics and a financial penalty mechanism in our proceeding that we must conduct pursuant to 47 U.S.C. § 271.

customers have experienced a high busy signal rate when calling to report service troubles to Verizon Maine's repair center.

The OPA's recommended "Dial Tone Speed" metric for Host-Remote clusters is not necessary. Delayed dial tone has nothing to do with the host-remote cluster's umbilical trunk connections; dial tone is delayed when customers' line units at their serving switches are congested when they attempt to make calls. Thus, dial tone delay is an event that happens at a customer's local central office, not in the host-remote network.

We do not agree with the OPA's recommended new service reliability metrics for service outages and interoffice fiber and SS7 network failures. We especially do not agree with the magnitude of the financial penalties associated with those proposed metrics. The "Service Outage" metric in the original SQI, which is an adaptation of the comprehensive metric developed by the Network Reliability and Interoperability Council, covers all service outages and weights them according to the types of services that are lost, the number of access lines affected, and the duration of the outage. We agree with the OPA that the performance baseline for the "Service Outage" metric may have to be revised and will require Verizon Maine to update it for the revised SQI.

We agree with the reasoning behind the OPA's recommendation to increase the maximum customer rebate amount in the revised SQI, and we will increase it, but not to 4.5% of Verizon Maine's 2000 jurisdictional revenues, as the OPA recommends. For the original SQI we had set the maximum rebate amount, $11 million, at approximately 3.4% of Verizon Maine's 1995 revenues. We will apply that same percentage to the Company's 2000 revenues, which results in a maximum customer rebate of $12.5M, a 13.5% increase above the current maximum. We will also increase the maximum per-metric rebate amount by the same percentage, from $1M to $1.135M, and from $2M to $2.27M for the Service Outage metric.

2. Commission Adopted SQI

The Commission will adopt the SQI in Table 3. "TBD" (to be determined) means that Verizon Maine will provide data to the Commission as required below, in Section VII.E.6.

TABLE 3
REVISED Verizon Maine SQI

C = Changed metric   N = new metric

PERFORMANCE METRICS	BASELINES
CUSTOMER SERVICE	
(C) 1. Premise Installations: % Appointments Not Met – Company Reasons	TBD
(C) 2. Mechanized Installations:% Appointments Not Met – Company Reasons	TBD
(N) 3. Premise Repairs:- % Appointments Not Met – Company Reasons	TBD
(N) 4. Mechanized Repairs: % Appointments Not Met – Company Reasons	TBD
(C) 5. Held Orders - Average Delay Days	TBD
6. Business Office calls: % Answered over 20 seconds	31
(N) 7. Repair Service Calls: % Answered over 20 seconds	TBD
SERVICE RELIABILITY	
8. Customer Trouble Reports Rate per 100 lines	1.08
(N) 9. Repeat Trouble Reports Rate per 100 lines	TBD
10. % Troubles not cleared within 24 hrs – Residential Customers	21.1
11. % Troubles Not Cleared within 24 hours - Business Customers	9.0
12. Dial Tone Speed % over 3 seconds	0.36
(N) 13. % Blocked Calls	TBD
(C) 14. Service Outage	TBD
CUSTOMER SATISFACTION	
(N) 15. PUC Complaint Ratio	TBD

3. New Metrics in the Revised SQI

a. Premise Repair Appointments; % Not Met on Time – Company Reasons

b. Mechanized Repair Appointment: % Not Met on Time – Company Reasons

Verizon Maine's performance in keeping repair appointments is just as important to its customers as its performance in keeping service installation appointments. We will measure Verizon Maine's performance in keeping its repair appointments both for repairs that require premise visits and repairs the Company can accomplish remotely, by its mechanized "flow-through" process. The Company's performance in keeping premise repair appointments is a particular concern: because Verizon Maine only promises the repair will be done sometime during the appointed day, the Company requires customers to be at the home or business all day.

c. Repair Service Calls: % Answered in over 20 Seconds

We believe this metric is as important to measure as Verizon Maine's Business Office call answering performance. As we have with the Business Office call answering metric, we will require Verizon Maine to restrict the Repair Service call answering metric to calls answered by a live person.

d. % Repeat Trouble Reports

"Repeat troubles" are recurring service problems customers report within 30 days of their initial trouble reports. Although the Troubles Not Cleared within 24 hours metric measures Verizon Maine's repair performance, it does not measure whether the repairs hold up; the % Repeat Trouble Reports metric does.

e. % Blocked Calls

This is a much-needed network congestion metric, which will measure terminating and originating call blocking during the busy hours of all sources of call blocking in Verizon Maine's network: access line termination units, umbilical trunks, interoffice trunks and links between switch modules.

f. PUC Complaint Ratio

As indicated in the FNOI, this metric is included in the NARUC's Service Quality White Paper metrics, and the OPA has recommended that we include it in the revised SQI. The original SQI lacked any metric that measured customer dissatisfaction with such services as billing, credit and collection, operator services, responses made to customers by Verizon Maine's business office, repair centers, and customer care centers. The "Complaint Ratio" will measure Verizon Maine's performance in dealing with these issues.

The OPA recommended that the Commission continue to measure and include customer satisfaction in the SQI, as measured by survey instruments and require Verizon to have an independent survey expert review the Company's practices in designing and gathering data to ensure that it is statistically valid. The OPA also recommended that we measure the rate at which Verizon's customers file complaints against the company for issues related to local service. The OPA based this recommendation on two events: the Commission’s request to meet with the Company to discuss a recent surge in complaints; and the complaint filed by the Communications Workers of America (CWA) against Verizon's New York affiliate. The OPA stated that it is concerned that the types of data manipulation that are alleged in New York could occur here in Maine. For these two reasons, the OPA stated that "measuring the PUC Complaint Ratio will provide a backstop for such possible misconduct and serve as another tool for measuring overall customer satisfaction."

The OPA also recommended that the SQI be more heavily weighted to actual experiences between customers and Verizon Maine than can be measured with small sample customer surveys. We believe the “PUC Complaint Ratio” achieves this goal, because it is an objective measure that will not be influenced by a customer’s mood at the time the survey is administered or by the way that a question may be posed.

We agree with the OPA that we should continue measuring customer satisfaction as part of a new SQI and that the PUC complaint ratio is a good measure of overall customer satisfaction. We therefore eliminate the four survey metrics relating to provisioning and maintenance used in the original SQI to measure customer satisfaction and replace them with the PUC complaint ratio.

The “PUC Complaint Ratio” will replace subjective measures (the surveys) with a more encompassing, objective measure. The surveys are the only metrics in the original AFOR that measured customer satisfaction with the Company's service. Yet these metrics examined only the Company's performance for provisioning and maintenance. Compounding this problem of limited performance scope, only a small sample of the residential and business customers that utilized Verizon Maine's provisioning and maintenance services was surveyed. The “PUC Complaint Ratio,” on the other hand, will measure all the Company's services provided to all customers, from installations and repairs to billing and collections. Consequently, the “PUC Complaint Ratio” will capture areas of customer dissatisfaction that the provisioning and maintenance surveys would not. In addition, while we do not necessarily believe that Verizon Maine will experience the same problems as those alleged in New York by the CWA, the “PUC Complaint Ratio” nonetheless will address the OPA's concern of potential data manipulation by the Company by providing an objective measure of service quality that is outside of the Company's control.

In its Brief on Exceptions to the Examiner’s Report, Verizon Maine opposes the inclusion of the complaint ratio in the SQI because the metric would be “far too subjective and unwieldy to convey accurate information on the level of

Verizon Maine's Service Quality." Verizon stated that complaints are frequently made on non-service quality issues such as Basic Service Calling Area limitations, line extensions, pole attachments, etc., and that many other complaints served on Verizon Maine do not relate to services it provides (e.g., interexchange carrier disputes).

We disagree. The "PUC Complaint Ratio" is a good indicator of the Company's overall service provided to customers. Customers who are not satisfied with the Company's service, whether it is repair service, installation service, or credit and collections service, may file a complaint against the Company. The number of complaints filed against the Company is, therefore, a reasonable indicator of overall customer dissatisfaction with the Company. In addition, the Complaint ratio is an indicator of the Company's quality of service provided to customers who contact the Company seeking assistance. Complaints are taken by the Commission only after the Company has been afforded an opportunity to address the customer's concern directly with the customer. If Verizon Maine fails to resolve the matter to the customer's satisfaction, the customer may then file a complaint against the Company with the Commission.

The Company argued that the Complaint Ratio is not a good indicator of service quality because many complaints are without merit. The Company provided no evidence, however, that the percentage of complaints in which it is found to be not at fault is likely to vary depending on the level of total complaints. Accordingly, it is likely that an increase in the total number of complaints is a reasonable indicator of an increase in service problems. More to the point, the Consumer Assistance Division (CAD) carefully considers the calls it receives to ensure that only complaints that have possible merit are accepted. For example, a customer must first attempt to resolve a dispute directly with the utility before the CAD will accept a complaint. In addition, the CAD does not accept complaints from customers regarding issues over which the Commission has no jurisdiction (e.g., interstate issues) or which the CAD has no ability to resolve (e.g., a complaint about an approved tariff rate). This is not to say that the CAD accepts complaints only where it is obvious that the utility is at fault; rather, the complaints are reviewed and accepted only after it is determined that the customer has complained to the utility, that the utility has had an adequate opportunity to resolve the matter, that the Maine PUC has jurisdiction, and that the CAD has the authority to resolve the dispute.

Verizon Maine argued that the inclusion of the "PUC Complaint Ratio" metric would amount to "double jeopardy" in that customers who are unhappy with its service would likely be included under another SQI measurement. While it is true that some customer complaints may be reflected in other metrics, many service quality areas for which customers have complaints would not, e.g., Verizon Maine's quality of service provided to customers who contact the Company seeking assistance. In addition, the same argument could be made regarding the provisioning and maintenance surveys that the PUC Complaint Ratio will replace. The surveys measured customer dissatisfaction with provisioning (installation) and maintenance (repair). Yet both installation and repair performance were also measured in the original

SQI by the "Installation - % Appointments Not Met" and "% Troubles Not Cleared Within 24 Hrs" metrics.

The complaint ratio will be expressed as the number of complaints filed against the Company per 1,000 customers. The ratio will be calculated using the number of complaints that are filed against Verizon Maine with the Commission in the 12-month period during which the SQI is measured. Both residential and business customer complaints will be included in the complaint ratio. Complaints will be defined as customer contacts to the Consumer Assistance Division (CAD) where the customer has a dispute that he or she has been unable to resolve with the Company, that appears to have merit, and that the CAD should resolve. This is the same definition that the CAD has used in the past. Customers who contact the CAD who have not previously contacted the Company are referred to the Company.

All complaints filed against Verizon Maine will be included in the PUC Complaint Ratio. The OPA recommends that only complaints involving "local service" be included in the ratio calculation. We disagree. The CAD receives a significant number of complaints involving Verizon toll service and billings. In addition, Verizon provides toll service to a large percentage of its local exchange customers and complaints are not always easily separated into “local” and “toll” components. Moreover, historical complaint numbers used to calculate the recommended baseline include complaints involving all of Verizon Maine's services. To differentiate local service complaints from other complaints on an ongoing basis would not only involve a significant effort, but would also require a similar differentiation of historical data (necessary to establish the correct baseline for a local service only metric) that would be difficult, if not impossible.

4. Changed Metrics in the Revised SQI

These “changed” metrics are modifications of metrics in the original SQI.

a. Premise Installations - % Appointment Not Met on Time – Company Reasons

b. Mechanized Installation - % Appointments Not Met or Time – Company Reasons

These metrics are refinements of the Installations Not Met metric in the original SQI. We will require Verizon Maine to measure its premise and mechanized installation performance separately. As with repair appointments, the Company’s performance in keeping premise installation appointments is a particular concern because the Company only promises service will be installed sometime during the appointed day, potentially requiring customers to be at the home or business all day.

c. Held Orders – Average Delay Days

This metric will measure the number of "delay days" between customers' promised installation dates and the dates the installations are actually completed, averaged over all customers with orders delayed for Company reasons. The Held Order metric in the original SQI measured the average annual total delay days, which is difficult to understand and to relate to how long Verizon Maine's customers with delayed orders are being made to wait for service. We therefore replace it with the revised calculation.

d. Service Outage

We will update the baseline for this metric. Our reasoning is explained in Section VII.E.6 (Performance Baselines) below.

5. The Customer Survey Metrics

The original SQI has four metrics that measured, through small sample monthly surveys by a Verizon vendor, residential and business customer dissatisfaction with Verizon Maine's service provisioning and repair performance. We have eliminated these metrics because we doubt that the survey sample size is adequate or that the survey process itself is sufficiently objective and consistently conducted from one interviewer to another.[19] For these reasons, we have not placed a great deal of weight on these sample survey-based metrics. We believe both the old and new metrics in the revised SQI cover customer dissatisfaction with Verizon Maine's provisioning and repair performance more thoroughly and more objectively than the sample survey-based metrics. In particular, the CAD Complaint Ratio measures Verizon Maine's performance in these and all other areas. We note that Verizon provides the FCC customer satisfaction survey data as a condition of its approval of the Bell Atlantic-GTE merger; thus, we will be able to monitor that data.

6. Performance Baselines

Verizon Maine believes the purpose of a revised SQI and its performance baselines should be the same as it was for the original SQI: to ensure that

[19]According to Verizon Maine's comments on the FNOI, the survey is based on approximately 50 Verizon Maine customers per month who have had service installed or repaired. Although that amounts to an annual sample size of 600, it is actually only 150 per metric, which we do not believe provides either an adequate level of statistical confidence or a small enough margin of error. During hearings the bench asked Verizon Maine's service quality witness, Linda Thoms, to provide evidence that the month-to-month survey data are not correlated (which would allow the monthly data to be pooled and treated as a single sample). Ms. Thoms responded to the question in a data response. It provided no evidence, and instead seems to indicate there *is* month-to-month, serial correlation in the survey data, which means the monthly data should not be pooled.

Verizon Maine's service levels under the AFOR would not deteriorate from the levels achieved prior to that time under rate of return regulation. Therefore, the performance baselines should not be changed from those in effect during the original AFOR. The OPA believes the performance baselines should reflect Verizon Maine's historical performance and be based on a review of the degree of variability in it and any trends in recent performance.

We agree with the OPA. We are particularly concerned that we not adopt baselines that reflect declines in Verizon Maine's performance. Accordingly, in its compliance filing to this order, we will require Verizon Maine to provide monthly service quality data for the new and changed metrics in the revised SQI for the years 97-98, 98-99, and 99-2000;the baselines for these metrics will be set at Verizon Maine's average annual performance levels for those three years. For the metrics that are unchanged from the original SQI, we will retain their existing baselines.

We will not change the Dial Tone Speed metric's baseline of .36% to .1%, as the OPA recommended. We agreed to increase the original 0.04% baseline in annual steps to the current level because of the Internet's impact on Verizon Maine's network, and to prevent the Company from making line unit investments just to maintain the 0.04% performance level so as to avoid paying penalties. Verizon Maine's response to a bench data request shows that the current 0.36% baseline is the lowest DTS baseline in Verizon's national service territory.

We will update the Service Outage metric's baseline based on its most recent 3-year performance. Because of the state-wide toll isolation caused by the Verizon Maine outages in Freeport in 1995 and Topsham in 1996, we added this metric to the SQI in the 97-98 SQI reporting year primarily as an incentive to Verizon Maine to create more physical route diversity in its interoffice network, which it has accomplished with the construction of its service territory-wide "self-healing" SONET rings. We believe the performance baseline for the Service Outage metric should reflect the effects of Verizon Maine's high-performance interoffice network on its outage performance.

Regarding the new % Blocked Calls metric's baseline, the FNOI noted that 3% is the recommended busy hour-based call blocking standard in NARUC's Model Telecommunications Service Rules. Verizon Maine's comments on the FNOI indicated this level would be reasonable as a wire center-based standard. We therefore adopt, as the baseline for the % Blocked Calls metric, the lower of 3% or, the average of the monthly percentages of blocked calls data over the last three years.

7. Reporting

We will require Verizon Maine to file SQI reports monthly. The Company should continue filing reports pursuant to the metrics in the original SQI metrics until we adopt baselines for the new and changed metrics in the revised SQI.

8. Other OPA Service Quality Recommendations

a. The OPA recommends the Commission order Verizon Maine to send its customers an annual service quality report. We will not order Verizon Maine to do so. We will require Verizon Maine to continue placing on any customer bills containing service quality rebates the notation: "REBATE FOR BELOW-STANDARD SERVICE QUALITY" next to the rebate amount. As under the current AFOR, if the annual penalty exceeds $750,000, the Company shall provide the rebates to customers in equal credits in 12 monthly bills.

b. The OPA recommends that the Commission order Verizon Maine to compensate customers when it misses repair appointments or service installation dates for Company reasons by providing affected customers with a fixed amount or a waiver of charges. We will not require Verizon Maine to implement such a procedure, because the Company will be subject to paying customer rebates in the revised SQI for failing to meet the baselines of two installation and two repair performance metrics.

c. The OPA recommends the Commission order Verizon Maine to make customer rebates automatic in its tariffs when local service and other services are interrupted beyond specific lengths of time. To receive such rebates, Verizon Maine's tariff require customers to bring service outages to its attention within ten days of the outage. In its exceptions to the Examiner's Report, Verizon Maine said it does not know if customers lose service until they report it to Verizon-New England's Repair Center. If customers do so (and do so within 10 days of the outage) and the lengths of their outage durations meet the tariff, the Company asserts the rebates are already automatic; those customers do not have to request them.

It is unlikely that very many customers would be aware of the existence of the tariff provisions, the rebates or the requirement to request them within 10 days of the outages. Furthermore, based on outage reports Verizon Maine files pursuant to Chapter 200 of our rules, we are aware that outages can affect all customers in entire wire centers. In such instances of wide-spread outages, it is not necessary for *all* customers in the affected wire centers to call its Repair Center for the Company to know they have lost service and the length of time they have lost it. Therefore, for any outage the Company knows of – by whatever means – and knows which customers it affected, if the outage duration meets the tariff, the Company should provide rebates to those customers automatically. Such customers should not have to bring the outage to Verizon Maine's attention within 10 days of the outage to qualify for rebates. In its compliance filing to this Order, Verizon Maine should revise its tariff accordingly.[20]

[20]Verizon Maine's tariff indicates that basic exchange service must be interrupted for "over 24 hours" to qualify for a rebate, and the rebate is only 1/30 of the monthly rate times the duration of the outage (in days). Two points are relevant here: (1) the Commission's outage records show Verizon Maine outages lasting over 24 hours to be extremely rare events; and (2) a residential customer's rebate for being without basic

VIII. VERIZON INVESTMENT LEVELS IN MAINE

The Executive Branch (EB) agencies have proposed that the Commission establish a benchmark that compares technology deployment in Maine's service center communities with that deployed in the Route 128 region of Massachusetts or throughout the nation. The EB agencies also support a moderate increase to basic rates to encourage continued investment by the Company in Maine.

The OPA argues that the Commission should reject the EB proposals because: 1) economic theory suggests that new investments should be made on the basis of the expected return on the particular investment, not the overall expected return in the jurisdiction; and 2) the Commission should not put itself in a position of encouraging investment that might ultimately turn out to be unprofitable, and lead to Verizon seeking additional rate increases as compensation. Further, the OPA asserts that the Company's actual or implied threats to invest less in Maine, unless it receives favorable treatment on its request for higher basic service rates, are both "hollow and inappropriate." The OPA further states that giving credence to such threats will encourage them in the future. The OPA argues that such encouragement would permit Verizon to initiate a type of bidding war among jurisdictions, with each one seeking to get Verizon to invest by offering the highest return. Finally, the OPA states that while it shares the EB's hope that investment in telecommunications infrastructure in Maine will be vibrant and competition will develop, the OPA believes that the EB has proposed the wrong means and the wrong investor to achieve that worthwhile goal. The OPA asserts that the policy objective in Maine should be to allow the competitive marketplace to decide what services are offered and by whom.

The Commission has the responsibility to enforce all provisions of the statutes governing telecommunications in Maine, and encouraging the deployment of advanced services is established as a policy goal in both § 7101(2) and § 9103 (4). Nevertheless, the Commission must balance that objective against other statutory goals that may appear to have competing purposes, such as the promotion of universal service, the provision of service throughout the state at reasonably comparable rates and maintaining local rates at as low a cost as possible. The Commission has also expressed its desire to encourage the development of economic competition throughout the State.

While we share the intent stated by both the EB and the OPA that telecommunications infrastructure and the services offered in Maine should be as good or better than those offered in other jurisdictions, we do not believe that Verizon should be given any special incentives to invest in the State beyond those that it receives from our implementation of incentive regulation in general. Our policy remains that competition should determine the level of investment and the selection of investors in

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service for as long as a day-and-a-half would be less than a dollar. Thus, it is unlikely that the tariff changes we require will have a noticeable financial effect on Verizon Maine.

the telecommunications market, and that competition should be fair and open (a "level playing field"), as provided for in various sections of state and federal law. The current and revised AFORs both give Verizon full pricing flexibility on new or advanced services, to the extent permitted under applicable laws or FCC rulings, and the opportunity to realize fully the rewards that sound investments will bring. Only in the areas of basic service for residential and small business customers, operator services and directory assistance will we constrain Verizon's ability to raise its prices, and we do so because we find that workable competition does not exist at this time in the markets for those services. We also share the concern raised by the OPA that the Commission should be reluctant to designate any particular investment or technology for the underserved areas of Maine. Such a course would, in our view, place substantial and arguably unwarranted risk on ratepayers.

Despite our view that, in general, competition should control the type and amount of investment in the telecommunications industry in Maine, Verizon, as an ILEC, has certain obligations to maintain a level of service that is acceptable to the Commission throughout its service territory. Generally, the maintenance-of-service obligations apply only to those services considered essential or basic, but the individual services included in that category may change over time. There also may be circumstances in which the Commission or other State agencies may wish to encourage the placement of a particular type of infrastructure or the offering of new or advanced services that would not otherwise be made or offered under a purely economic decision. Those steps should be taken only after an examination of all alternatives and ramifications. If necessary in the future, we may further investigate and analyze this issue.

Dated at Augusta, Maine, this 25th day of June, 2001.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

CONCURRING OPINION OF CHAIRMAN WELCH

I concur with the Commission's decision to offset the decrease in access revenues caused by the operation of the access parity statute, 35-A M.R.S.A. § 7101-B. I also agree with the reasons for that decision stated in the Commission's Order. In particular, I agree that the access parity statute allows us to override any statutory directive that might be interpreted to restrict our authority to raise basic rates and that constitutional and other statutory requirements in some circumstances may compel us to allow increases in basic rates.

In this concurring opinion, I address an argument presented by the Public Advocate. The OPA opposed any increase in basic rates, relying in part on the admonition in 35-A M.R.S.A. § 7303(2) that rates for "traditional flat rate local telephone service" be "as low . . . as possible." The OPA's reliance on § 7303 is misplaced. First, Section 7303(2) has *never* meant that the Commission should sacrifice all other rate design objectives for the benefit of basic monthly rates. In fact, § 7303 as a whole refers narrowly to the issue of whether the Commission should encourage (or even permit) the use of local *measured* service as an alternative to flat-rated service. *See* § 7303(1). Read in context, the "as low . . . as possible" language means only that the Commission may not inflate the price of flat-rated service to levels that would stimulate migration to "optional" measured service. This interpretation is confirmed by § 7303(3), which sets forth, as the test for whether the Commission has complied with § 7303(2), whether more than ¾ of basic service customers purchase flat rate service. Put another way, § 7303(2) constrains the relationship between basic flat rate and basic measured rate – it does not suggest any relationship between the rates for basic and any other services, such as access or toll.

I recognize that in *Public Utilities Commission, Investigation into New England Telephone Company's Cost of Service and Rate Design,* Docket No. 92-130, we interpreted the "lowest possible rate" provision as imposing a separate requirement from the provisions restricting measured service. I also recognize that the Order in Docket No. 92-130, as well as the first AFOR Order in Docket No. 94-123, we interpreted the provision as a rate design directive limiting the circumstances when local rates could be increased to "circumstances each of which in effect amounts to a finding that an existing rate design is unreasonable and detrimental to overall rate levels or to the public interest." *First AFOR Order* at 9. My present view, however, is that the rulings in those cases are incorrect, and if it were necessary to address those rulings in a future case, I would consider overruling them.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Theresa L. O'Brien
Title: Vice President – RI Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-24 Please provide a complete and legible copy of any and all Verizon alternative regulation plans and/or deregulation plans that are currently PROPOSED for Verizon in the State of New York and/or in the states that comprise New England.

REPLY: Verizon RI's proposed alternative regulation plan was filed in this case.

Attached is a copy of the alternative regulatory plan filed by Verizon Vermont and currently before the Vermont Public Service Board in Docket 6959.

At this time, there are no alternative regulation plans proposed in the other New England states or New York.

ATTACHMENT
RI 3692
DIV 1-24
VZ# 24

VERIZON VERMONT

ALTERNATIVE REGULATION PLAN

Effective April 23, 2005

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

The Vermont Alternative Regulation Plan (AFOR Plan) establishes the method by which the Vermont Public Service Board (Board) will regulate the intrastate retail services offered by Verizon New England Inc. d/b/a Verizon Vermont (Verizon VT) and is established pursuant to 30 V.S.A. § 226(b). The AFOR Plan will have an initial term of three (3) years, commencing on April 23, 2005, and terminating on April 22, 2008; provided, however, that at any time after April 23, 2007, Verizon Vermont (Verizon VT) and the Department of Public Service (Department) may mutually agree to extend the term of the AFOR Plan up to an additional four (4) years from the termination date, subject to approval by the Board.

The terms of the AFOR Plan are as follows:

A. Residential Basic Services – Prices, terms, and conditions for Residential Basic Services may be changed at the discretion of Verizon VT. Any increase in prices is limited to 10% annually for each service. Exogenous events and revenue-neutral offsets are accounted for separately as provided in Paragraphs H and I below. Residential Basic Services are listed in Attachment A.

B. Lifeline Services – The Lifeline credit shall be increased by an amount equal to any increase in the Residential Basic Exchange Service rate implemented in accordance with Paragraph A above and Paragraph H below.

C. Residential Non-Basic Services – Prices, terms, and conditions for Residential Non-Basic Services and any new Residential Services may be changed at the discretion of Verizon VT. Existing Residential Non-Basic Services are listed in Attachment B.

D. Retail Business Services – Prices, terms, and conditions for intrastate Retail Business Services and any new Retail Business Services may be changed at the discretion of Verizon VT. Existing Retail Business Services are listed in Attachment C.

E. Other Services – Prices for other Verizon VT services shall be subject to price regulation except as described in Paragraph H below. Other Services include, among others, Switched Access, Special Access, Special Construction for Access Services, retail PAL and PASL, and Pole Attachments, and are listed in Attachment D.

F. Resale and UNE - The level of the Verizon VT's wholesale (resale) discount for retail services and Unbundled Network Elements (UNEs) will continue to be set in accordance with the Federal Telecommunications Act of 1996, as amended.

G. Poles and Conduit Charges – Prices for poles and conduits will be price regulated.

H. Exogenous Event

1) An exogenous event is one that is beyond the control of Verizon VT and that produces a positive or negative economic change in annual revenues and/or costs of regulated intrastate operations in excess of $1,000,000. Changes due to changes in the economy, the effects of competition, and inflation do not constitute Exogenous Events. For purposes of the AFOR Plan, Exogenous Event shall be limited to:

a) Changes in tax laws that impact Verizon VT;

b) Changes in Generally Accepted Accounting Principles that apply to Verizon VT or changes in the Federal Communications Commission (FCC) Uniform System of Accounts;

c) Any FCC rules changes pertaining to jurisdictional separations; and

d) Regulatory, judicial, or legislative changes affecting Verizon VT, including rules and orders that are necessary to implement such changes.

2) The Department or Verizon VT may propose a change in prices for any service listed in Attachment A or Attachment D to offset the economic change resulting from an exogenous event. The party proposing the change bears the burden of proof with respect to the change.

3) Price changes resulting from exogenous events must be approved by the Board.

I. Access Rates - Verizon VT may offset all or any portion of any Board-ordered reduction in intrastate access rates by a revenue neutral increase to Residential Basic Services, which may include Lifeline, provided, however, that no offset applies to Verizon VT-initiated tariff reductions for intrastate access rates.

J. Modifications - Verizon VT may petition the Board to modify any of the terms or conditions of the AFOR Plan: (i) to reflect the impact of relevant provisions or decisions enacted or issued subsequent to the Board's approval of the AFOR Plan of federal or state legislative, judicial or administrative bodies of competent jurisdiction; or (ii) to seek a revised form of regulation or deregulation of its operations based upon changes in market conditions. In any proceeding, the burden shall be on Verizon VT to establish the reasonable basis for the modification.

K. Service Withdrawal – Except for the services listed in Attachments A and D, Verizon VT may withdraw any existing service, provided, however, that Verizon VT must provide a customer notice at least 45 days prior to the withdrawal of any existing service.

L. Tariffs – To the extent required by applicable law, Verizon VT shall file tariffs with the Board for telecommunications service offerings subject to the Board's jurisdiction.

1) Tariff filings for services listed in Attachment D shall be subject to the notice and suspension provisions of 30 V.S.A. §§ 225, 226, and 227.

2) Tariff filings for services listed in Attachments A, B, and C shall not be subject to the notice and suspension provisions of 30 V.S.A. §§ 225, 226, and 227 and shall be effective upon filing. Verizon VT's filings for services listed in Attachments A, B, and C will include only (i) such data as needed to demonstrate compliance with relevant price floor requirements established by the Board and (ii) a statement of foreseeable impacts on customer privacy expectations.

3) The rates, terms and conditions of Special Contracts will have no limitations other than those agreed to by the customer and Verizon VT and the relevant price floor requirements established by the Board.

M. Service Quality - In the event that the Board finds that a retail service quality plan is required during the term of the AFOR Plan, a copy of Verizon VT's modified Retail Service Quality Plan designed in conjunction with the AFOR Plan is provided as Attachment E.

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

ATTACHMENT A

"Residential Basic Services"

Exchange Service	
Basic Exchange Services – Other (Res.)	PSB 20, Part M, Section 1.5.2
One-Party Non-optional Measured Service (Res.)	PSB 20, Part M, Section 1.5.3
Lifeline (to offset annual rate changes)	PSB 20, Part A, Section 1.6.1

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

ATTACHMENT B

"Residential Non-Basic Services"

Residential Non-Basic Services	
Customer Satisfaction Guarantee	PSB 20, Part A, Section 1.4.9
Automatic Credit	PSB 20, Part A, Section 1.4.10
Payment Plans	PSB 20, Part M, Section 1.1.3
Premises Work Charges	PSB 20, Part M, Section 1.3.2
Protection Equipment for Service to Power Stations	PSB 20, Part M, Section 1.4.1
Connecting Arrangements	PSB 20, Part M, Section 1.4.2
Directory Listing Service	PSB 20, Part M, Section 1.5.6
Directory Assistance Service	PSB 20, Part M, Section 1.5.7
Operator Call Completion Service	PSB 20, Part M, Section 1.5.8
Busy Line Verification and Busy Line Interrupt	PSB 20, Part M, Section 1.5.10
Call Mover Service	PSB 20, Part M, Section 1.5.11
National 411	PSB 20, Part M, Section 1.5.12
Extended Referral Service	PSB 20, Part M, Section 1.5.13
Custom Calling Services	PSB 20, Part M, Section 1.7.1
Remote Call Forwarding Service	PSB 20, Part M, Section 1.7.2
Special Reversed Charge Toll Service	PSB 20, Part M, Section 1.7.3
Reference of Calls	PSB 20, Part M, Section 1.7.5
Curb-A-Charge Service	PSB 20, Part M, Section 1.7.8
Distinctive Ring Service	PSB 20, Part M, Section 1.7.10
Phonesmart Service	PSB 20, Part M, Section 1.7.11
Gold Number Service	PSB 20, Part M, Section 1.7.12
Custom Redirect Service	PSB 20, Part M, Section 1.7.13
Message Telecommunications Service (MTS)	PSB 20, Part M, Section 1.9.1
Call Completion Platform Service	PSB 20, Part M, Section 1.9.2
Selective Calling Service (grandfathered in 1990)	PSB 20, Part M, Section 1.10.1
Sensible Minute Plan	PSB 20, Part M, Section 1.10.2
CallAround 802 Plan	PSB 20, Part M, Section 1.10.3
Netsaver Plus Calling Service	PSB 20, Part M, Section 1.10.5
Call Answering/Home Voice Mail	PSB 20, Part M, Section 1.13.1
Value Pack Service	PSB 20, Part M, Section 1.15.2
Call Manager Package	PSB 20, Part M, Section 1.15.3
Multi-Line Package Bonus Discount	PSB 20, Part M, Section 1.15.4
Local and Toll Package	PSB 20, Part M, Section 1.15.5
Verizon Local Package Extra/Verizon Local Package	PSB 20, Part M, Section 1.15.6
Package Bonus Discount	PSB 20, Part M, Section 1.15.8
Verizon Regional Package Extra	PSB 20, Part M, Section 1.15.10
Verizon Regional Package	PSB 20, Part M, Section 1.15.11
ISDN	PSB 20, Part M, Section 3.10

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

ATTACHMENT C

"Retail Business Services"

Retail Business Services	
Failure of Service	PSB 20, Part A, Section 1.4.4
Customer Satisfaction Guarantee	PSB 20, Part A, Section 1.4.9
Automatic Credits	PSB 20, Part A, Section 1.4.10
Cancellation, Change or Deferment	PSB 20, Part A, Section 1.5.1
Deposits	PSB 20, Part A, Section 1.5.6
Flexible Rate Pricing Plan	PSB 20, Part A, Section 1.7.5
Payment Plans	PSB 20, Part M, Section 1.1.3
One-time NRC	PSB 20, Part M, Section 1.3.1
Premises Work Charges	PSB 20, Part M, Section 1.3.2
Protection Equipment for Service to Power Stations	PSB 20, Part M, Section 1.4.1
Connecting Arrangements	PSB 20, Part M, Section 1.4.2
Basic Exchange Services – Other	PSB 20, Part M, Section 1.5.2
One Party Non-Optional Measured Service	PSB 20, Part M, Section 1.5.3
Other Adjunct Services	PSB 20, Part M, Section 1.5.5
Directory Listing Service	PSB 20, Part M, Section 1.5.6
Directory Assistance Service	PSB 20, Part M, Section 1.5.7
Operator Call Completion Service	PSB 20, Part M, Section 1.5.8
NYNEX Electronic White Pages	PSB 20, Part M, Section 1.5.9
Busy Line Verification and Busy Line Interrupt	PSB 20, Part M, Section 1.5.10
Call Mover Service	PSB 20, Part M, Section 1.5.11
National 411	PSB 20, Part M, Section 1.5.12
Extended Referral Service	PSB 20, Part M, Section 1.5.13
Custom Calling Services	PSB 20, Part M, Section 1.7.1
Remote Call Forwarding Service	PSB 20, Part M, Section 1.7.2
Special Reversed Charge Toll Service	PSB 20, Part M, Section 1.7.3
Line Hunting Service	PSB 20, Part M, Section 1.7.4
Reference of Calls	PSB 20, Part M, Section 1.7.5
Stop Hunt Arrangement	PSB 20, Part M, Section 1.7.6
Signal Line Filter	PSB 20, Part M, Section 1.7.7
Curb-A-Charge Service	PSB 20, Part M, Section 1.7.8
Simplified Message Desk Interface (SMDI)	PSB 20, Part M, Section 1.7.9
Distinctive Ring Service	PSB 20, Part M, Section 1.7.10
Phonesmart Service	PSB 20, Part M, Section 1.7.11
Gold Number Service	PSB 20, Part M, Section 1.7.12
Custom Redirect Service	PSB 20, Part M, Section 1.7.13
Message Telecommunications Service (MTS)	PSB 20, Part M, Section 1.9.1
Call Completion Platform Service	PSB 20, Part M, Section 1.9.2
Selective Calling Service	PSB 20, Part M, Section 1.10.1
Customized NetSaver Plan	PSB 20, Part M, Section 1.10.4
NetSaver Plus Calling Service	PSB 20, Part M, Section 1.10.5
Vermont Business Calling Service	PSB 20, Part M, Section 1.10.6
Vermont Business Plus Calling	PSB 20, Part M, Section 1.10.7

Vermont Business Package	PSB 20, Part M, Section 1.10.8
Vermont Business Package Plus	PSB 20, Part M, Section 1.10.9
Business Link	PSB 20, Part M, Section 1.10.10
Wide Area Telecommunications Service (WATS)	PSB 20, Part M, Section 1.11.1
Toll-Free Service	PSB 20, Part M, Section 1.11.2
Toll-Free Call Management Services	PSB 20, Part M, Section 1.11.3
Public Emergency Call Receiving Service	PSB 20, Part M, Section 1.12.1
DID for PBX Systems	PSB 20, Part M, Section 1.12.2
AIOD for PBX	PSB 20, Part M, Section 1.12.3
Toll Access Trunk Lines for PBX	PSB 20, Part M, Section 1.12.4
Toll Diversion Trunk Lines for PBX	PSB 20, Part M, Section 1.12.5
Trunk Multiplying Arrangements	PSB 20, Part M, Section 1.12.6
Arrangements for Toll Billing Information for PBX	PSB 20, Part M, Section 1.12.7
Special C. O. Terminal Equipment for PBX	PSB 20, Part M, Section 1.12.8
Message Registration for PBX	PSB 20, Part M, Section 1.12.9
Group Alerting System	PSB 20, Part M, Section 1.12.10
CO-LAN	PSB 20, Part M, Section 1.12.11
PS/ALI Trunks	PSB 20, Part M, Section 1.12.12
Call Answering/Home Voice Mail	PSB 20, Part M, Section 1.13.1
Voice Messaging Service (VMS)	PSB 20, Part M, Section 1.13.2
Worksmart Packages	PSB 20, Part M, Section 1.15.1
Corporate Rewards	PSB 20, Part M, Section 1.15.7
Advantage Pack	PSB 20, Part M, Section 1.15.9
Discounts and Credits	PSB 20, Part M, Section 1.16.1
Analog Private Line Services	
Joint Use Service	PSB 20, Part M, Section 2.1.1
Series 1000 Channels	PSB 20, Part M, Section 2.2.1
Series 2000 Channels	PSB 20, Part M, Section 2.3.1
Series 3000 Channels	PSB 20, Part M, Section 2.4.1
Series 6000 Channels	PSB 20, Part M, Section 2.5.1
Automatic Signaling	PSB 20, Part M, Section 2.6.1
Short Period Talking	PSB 20, Part M, Section 2.7.1
Digital Communications Services	
Superpath 1.544 Mbps	PSB 20, Part M, Section 3.2
Infopath Packet Switching Service	PSB 20, Part M, Section 3.4
Digital PBX Services	PSB 20, Part M, Section 3.5
Enhanced FlexGrow Service	PSB 20, Part M, Section 3.7
Digipath Digital Service II (DDS II)	PSB 20, Part M, Section 3.9
ISDN	PSB 20, Part M, Section 3.10
Network Reconfiguration Service	PSB 20, Part M, Section 3.11
Advanced Data Services	
Frame Relay – Monthly Service Plan	PSB 20, Part M, Section 4.1.1
Frame Relay – Service Period Plan	PSB 20, Part M, Section 4.1.2
Frame Relay – NRCs	PSB 20, Part M, Section 4.1.3
Transparent LAN Service	PSB 20, Part M, Section 4.1.4
Centrex	
CLAS	PSB 20, Part M, Section 8.2.1
Electronic Central Office Features	PSB 20, Part M, Section 8.2.2

Centrex Diversion Arrangements	PSB 20, Part M, Section 8.2.3
Intellismart	PSB 20, Part M, Section 8.2.4
Centrex Call Management	PSB 20, Part M, Section 8.2.5
Digital Centrex Additional Features	PSB 20, Part M, Section 8.2.6
Terminating Number Screening	PSB 20, Part M, Section 8.3.1
Trunk Line Terminations	PSB 20, Part M, Section 8.3.2
Tie Line Terminations	PSB 20, Part M, Section 8.3.3
Group Terminations	PSB 20, Part M, Section 8.3.4
Advanced Private Line Terminations	PSB 20, Part M, Section 8.3.5
Switched Service Network Access Line Terminals	PSB 20, Part M, Section 8.3.6
Nova Centrex	PSB 20, Part M, Section 8.4.1
Superseded Analog Centrex Services	PSB 20, Part M, Section 8.4.2
Intellipath Digital Centrex Service	PSB 20, Part M, Section 8.5.1
Digital Centrex Plus Service	PSB 20, Part M, Section 8.5.2
Special Contracts	

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

ATTACHMENT D

"Other Services"

1.	**Exchange Service**	
	Universal Service Fund (Res. and Bus.)	PSB 20, Part M, Section 1.1.1
2.	**Customer Assistance Programs**	
	Link Up America (Residence)	PSB 20, Part M, Section 1.1.2
	Lifeline	PSB 20, Part A, Section 1.6.1
3.	**Other Services**	
A.	PAL & PASL	
	- Public Access Smart-Pay (PASL) Service	PSB 20, Part M, Section 1.8.1
	- Public Access Line (PAL) Curb-A-Charge Service	PSB 20, Part M, Section 1.8.2
	- PAL and PASL Directory Assistance	PSB 20, Part M, Section 1.5.7
B.	Collocation	PSB 22, Part M, Section 5
4.	**Switched Access**	PSB VT No. 23, Section 30.6
5.	**Special Access**	PSB VT No. 23, Section 30.7
6.	**Special Construction for Access Services**	PSB VT No. 24
7.	**Interconnection Services**	SGAT, Section 4

VERIZON VERMONT
ALTERNATIVE REGULATION PLAN

ATTACHMENT E

RETAIL SERVICE QUALITY PLAN

Section 1: Plan Provisions

I. Introduction

The Verizon Vermont Retail Service Quality Plan (RSQP or Plan) is a self-executing remedy plan that ensures Verizon Vermont (Verizon VT) provides quality service to its retail customers. The RSQP calls for Verizon VT to maintain specified service levels.

The RSQP is designed to evaluate the overall level of service provided by Verizon VT to its retail customers. It is focused on eight key measures that cover Verizon VT's service and quantifies performance on a state-wide basis. The RSQP includes evaluation criteria, and results under the Plan are reported on a monthly basis. If Verizon VT fails to satisfy the Plan's requirements in any month, then the company will submit to the Board and the Department a performance improvement plan (PIP) outlining specific actions to be taken to correct any service deficiency.

II. Provisions of the Plan

A. Measures Included

The Service Quality Plan consists of eight measures broken down into three major categories: Network Performance, Maintenance Service Items and Installation Service Items. The Network Performance items measure the reliability of the local telephone network. The

Maintenance Service items measure Verizon VT's performance in responding to customer trouble reports. The Installation Service items measure Verizon VT's performance in provisioning new services. Overall, the eight measures included in the Service Quality Plan provide a comprehensive view of the level of service provided by Verizon VT to its retail customers.

Listed below are the specific measures included in the plan. The definition of each measure is provided in Section 2.

Network Performance Items:
Network Trouble Report Rate
Service Outages

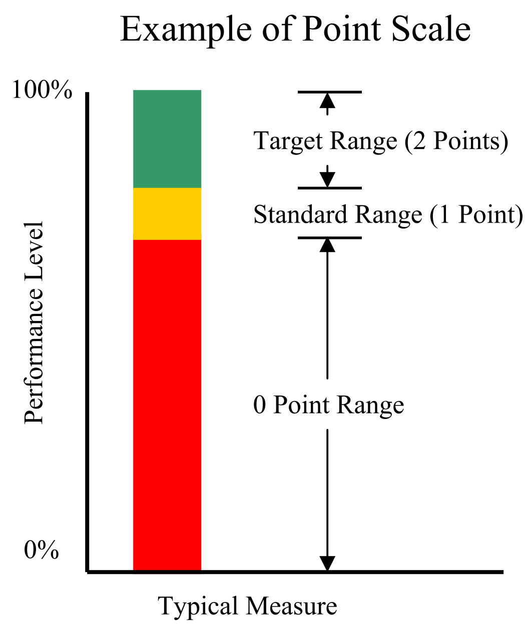
Maintenance Service Items:
Percent of Troubles Cleared within 24 Hours – Residence
Percent of Troubles Cleared within 24 Hours – Business

Installation Service Items:
Percent of Appointments Missed for Company Reasons – Residence
Percent of Appointments Missed for Company Reasons – Business
Percent of Appointments Missed for Company Reasons – Company Facilities
Held Orders – Average Delay Days

B. Standards

The Service Quality Plan specifies two levels of service performance with associated thresholds for each of the eight measures included: the "standard" level and the "target" level. Each level is also assigned a point value that is used in evaluating overall performance under the Plan (described further below). Performance results that are at or greater than the "target" threshold are assigned two points under the Plan. Performance results that are at or greater than the "standard" threshold, but not at the "target" level, are assigned one point under the Plan. Performance results that are below the prescribed "standard" level are assigned zero points.

Following is a representative example of a performance measure and its associated performance standards.



C. Evaluation Criteria

The Service Quality Plan assesses performance based on total service quality points achieved. The Plan requires that Verizon VT achieve a level of 8 service quality points in each month. The total service quality points are determined on a monthly basis as follows:

- Calculate Performance – Performance for each measure is calculated on a 12-month, rolling basis. This requires that 12 months' of data is always used in calculating performance for each measure. For example, the reported results for a given month will be based on performance in that month and the preceding 11 months. Results for May will capture performance from the preceding June through May; results for June will capture performance from the preceding July through June.

- Score Performance – The reported performance for each measure will then be scored against the established thresholds for "standard" and "target" performance and given a point value of either zero, one or two points.
- Determine Total SQI Points – All of the points scored on the Network Performance, Maintenance and Installation measures are added to determine the overall service quality point score for the given month. Verizon VT must obtain a total of 8 points. If the total score for a given month is less than 8 points, Verizon VT will file a performance improvement plan addressing the specific areas requiring improvement.

D. Reporting and PIP Provisions

Verizon VT will provide a monthly Quality of Service (QOS) report to the Board and the Department outlining its performance under the Plan. The monthly report will be filed by no later than the 15th day of the following month being reported. The QOS report will include both the official 12-month rolling results and current, stand-alone monthly results for the eight performance measures defined in the plan. In addition, within 45 days from the end of the reporting month, Verizon VT will file a performance improvement plan (PIP) for any month in which the company did not meet the Plan's requirements. The PIP will outline the specific actions Verizon VT plans to undertake to improve service quality.

E. Exceptions and Waiver Process

Recognizing that service quality may be influenced by factors beyond Verizon VT's control, Verizon VT may file Exception or Waiver petitions with the Board seeking to have monthly service quality results modified. Circumstances that would qualify for such consideration include, but are not limited to, acts of God; acts of civil or military authorities;

legislative, executive or judicial acts of any governmental entity; government regulation; embargoes; epidemics; war; terrorist acts; riots; insurrections; fires; explosions; earthquakes; nuclear accidents; floods, hurricanes, blizzards, or other major environmental disturbances; power blackouts; strikes; or any other events for which Verizon VT is not at fault and are beyond its control. Such circumstances may occur in any state served by a Verizon service center that affects Verizon VT results.

Any petition pursuant to this provision must demonstrate clearly and convincingly the extraordinary nature of the circumstances, the impact that the circumstances had on Verizon VT's service quality, why Verizon VT's normal, reasonable preparations for difficult situations proved inadequate, and the specific days affected by the event. The petition must be filed within 45 days from the end of month in which the event occurred.

The Board will determine which, if any, of the daily and monthly results should be adjusted in light of the extraordinary event cited.

F. Term of the Plan

The term of the Retail Service Quality Plan shall be coincident with Verizon VT's Alternative Regulation Plan.

Section 2: Measure Definitions

Measure Network Trouble Report Rate	
Definition: This metric measures the total initial customer direct or referred troubles reported, where the trouble disposition was found to be in the network, per 100 lines in service. Network trouble means a trouble with a disposition code of 03 (Drop wire), 04 (Outside Plant Loop), 05 (Central Office), 07 (Trouble tested OK), 08 (Trouble dispatched and found OK in Central Office), and 09a (Trouble dispatched and found OK in Outside Plant).	
Exclusions: The following trouble reports are excluded from the calculation of report rate: • Subsequent reports (A subsequent report is an additional customer trouble report on a line while the original report is still pending, typically for status or to change or update information.) • Troubles reported on Verizon official (administrative) lines • Troubles closed due to customer action (disposition code 06) • Troubles reported to Verizon employees in the course of performing preventative maintenance, where no customer has reported a trouble • Troubles found in customer premise equipment (CPE, disposition code 12)	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 2.25 1.90
Calculation: *Numerator:* Number of network troubles	 *Denominator:* Number of lines in service (divided by 100)

Measure Service Outages	
Definition: This metric measures the number of network service outages where 5000 or more customers lose dial tone service for a period of 30 minutes or more.	
Exclusions: • None	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 1 outage 0 outages
Calculation: Count of the number of outages where 5000 or more customers lose dial tone service for a period of 30 minutes or more.	

Measure Percent of Trouble Cleared within 24 Hours – Residence	
Definition: This metric measures the percentage of network troubles (as defined for Network Trouble Report Rate) for residence customers that are cleared within 24 hours of receipt of the original report. This measure counts both out of service troubles (OOS) and customer affecting troubles.	
Exclusions: All troubles reported on residence lines that are scored as a network trouble (as defined for Network Trouble Report Rate) are counted toward this measure.	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 50% 70%
Calculation: *Numerator:* Number of residence network troubles where the clear date and time minus trouble receipt date and time is less than or equal to 24 hours	*Denominator:* Number of residence network troubles

Measure Percent of Trouble Cleared within 24 Hours – Business	
Definition: This metric measures the percentage of network troubles (as defined for Network Trouble Report Rate) for business customers that are cleared within 24 hours of receipt of the original report. This measure counts both out of service troubles (OOS) and customer affecting troubles.	
Exclusions: All troubles reported on business lines that are scored as a network trouble (as defined for Network Trouble Report Rate) are counted toward this measure.	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 75% 85%
Calculation: *Numerator:* Number of business network troubles where the clear date and time minus trouble receipt date and time is less than or equal to 24 hours	*Denominator:* Number of business network troubles

Measure Percent of Missed Installation Appointments for Company Reasons – Residence	
Definition: This metric measures the percentage of residence local exchange installation requests that are completed after the commitment date where the reason for the missed commitment is due to the company. These service requests include the initiation of new service and miscellaneous changes to existing service.	
Exclusions: The following service orders are excluded from the calculation of this metric: • Orders missed due to customer action • Disconnect orders • Verizon administrative orders • Additional segments on orders (parts of a whole order a included in the whole) • Orders that are not complete (Orders are counted in the month that they are completed) • Suspend for non-payment and associated restore orders	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 3.0% 2.5%
Calculation: *Numerator:* Number of residence orders where the order completion date is greater than the order due date due to company reasons	 *Denominator:* Number of residence orders completed

Measure
Percent of Missed Installation Appointments for Company Reasons – Business

Definition:
This metric measures the percentage of business local exchange installation requests that are completed after the commitment date where the reason for the missed commitment is due to the company. These service requests include the initiation of new service and miscellaneous changes to existing service.

Exclusions:
The following service orders are excluded from the calculation of this metric:
- Orders missed due to customer action
- Disconnect orders
- Verizon administrative orders
- Additional segments on orders (parts of a whole order a included in the whole)
- Orders that are not complete (Orders are counted in the month that they are completed)
- Suspend for non-payment and associated restore orders

Performance Standard:

Standard Threshold (1 point)	3.0%
Target Threshold (2 points)	2.5%

Calculation:

Numerator: Number of business orders where the order completion date is greater than the order due date due to company reasons	*Denominator:* Number of business orders completed

Measure
Percent of Missed Installation Appointments for Company Facilities

Definition:
This metric measures the percentage of residence and business local exchange installation requests that are completed after the commitment date where the reason for the missed commitment is due to a lack of facilities.

Exclusions:
The following service orders are excluded from the calculation of this metric:
- Disconnect orders
- Verizon administrative orders
- Additional segments on orders (parts of a whole order a included in the whole)
- Orders that are not complete (Orders are counted in the month that they are completed)
- Suspend for non-payment and associated restore orders

Performance Standard:

Standard Threshold (1 point)	0.9%
Target Threshold (2 points)	0.7%

Calculation:

Numerator: Number of residence and business orders where the order completion date is greater than the order due date due to a lack of facilities	*Denominator:* Number of residence and business orders completed

Measure Held Orders – Average Delay Days	
Definition: This metric measures the average number of delay days associated with orders missed due to facility reasons.	
Exclusions: The orders counted towards this metric are those used to determine Percent of Missed Installation Appointments for Company Facilities as defined within this plan.	
Performance Standard: Standard Threshold (1 point) Target Threshold (2 points)	 18 days 16 days
Calculation: *Numerator:* Total number of delay days associated with each held order.	 *Denominator:* Number of residence and business orders where the order completion date is greater than the order due date due to a lack of facilities

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Robert J. Kenney
Title: Executive Director - Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-25 Please provide a schedule or schedules that shows (show), at Verizon RI's cost of capital at the time when the schedules were first prepared, the long run incremental cost for Verizon RI to provide a residential single party local exchange access line. Based on that long run incremental cost, what monthly rate would apply for such lines in RI?

REPLY: Objection: Verizon RI objects to this Data Request on the grounds that it is vague, confusing and, to the extent it implies that Verizon RI's rates are governed by rate-of-return regulation, seeks information that is not relevant to the subject of this proceeding nor reasonably calculated to lead to the discovery of admissible evidence. In addition, the final sentence of this request poses a hypothetical question that fails to specify sufficient conditions to allow Verizon RI to respond.

Subject to the above objection, Verizon RI states that in the past, Verizon RI relied upon Massachusetts' forward looking costs rather than a Rhode Island specific LRIC study. More recently, the Rhode Island Commission approved TELRIC rates that are intended to be based on forward looking costs. The cost of capital approved in the TELRIC proceeding was 9.5%. In an effort to be responsive, Verizon RI provides the following chart comparing its current retail rate for residential measured service (which includes 90 minutes of local usage) with the approved TELRIC charges for a loop, port and 90 minutes of local usage – by density zone.

TELRIC Loop/Port/Usage Cost	RI Measured Service Rate

Urban	$13.44	$8.17
Suburban	$17.69	$8.17
Rural	$21.38	$8.17

VZ # 25

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Robert J. Kenney
Title: Executive Director - Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-26 Please supply a complete and legible copy of the Verizon RI tariff pages that pertain to residential local exchange access in RI.

REPLY: Please see the attached (hard copy only). In addition, Verizon RI's tariffs may be accessed via the PUC's website by clicking on the following link: http://www.ripuc.org/utilityinfo/telecom.html

VZ # 26

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Robert J. Kenney
Title: Executive Director - Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-27 Please supply a complete and legible copy of the report to which reference is made at Footnote No. 3 to Mr. Kenney's pre-filed direct testimony.

REPLY: Please see attached.

VZ # 27

NEWS

Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

News Media Information 202 / 418-0500
Internet: http://www.fcc.gov
TTY: 1-888-835-5322

FOR IMMEDIATE RELEASE
July 7, 2005

NEWS MEDIA CONTACT:
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Email: mark.wigfield@fcc.gov

FEDERAL COMMUNICATIONS COMMISSION RELEASES DATA ON HIGH-SPEED SERVICES FOR INTERNET ACCESS

High-Speed Connections to the Internet Increased 34% During 2004 for a Total of 38 Million Lines in Service

Washington, D.C. – The Federal Communications Commission (FCC) today released new data on high-speed connections to the Internet in the United States. Twice a year, facilities-based broadband providers must report the number of high-speed connections in service pursuant to the FCC's local competition and broadband data gathering program (FCC Form 477).

For reporting purposes, ***high-speed lines*** are connections that deliver services at speeds exceeding 200 kilobits per second (kbps) in at least one direction, while ***advanced services lines*** are connections that deliver services at speeds exceeding 200 kbps in both directions.

For the purposes of this report we collected data from providers with at least 250 high-speed lines in a state. Statistics released today reflect data as of December 31, 2004 filed by providers on FCC Form 477 in the Commission's local competition and broadband data gathering program.

1) High-Speed Lines

- During the year 2004, high-speed lines serving residential, small business, larger business, and other subscribers increased by 34%, to 37.9 million lines. The increase was 17% during the second half of 2004, from 32.5 million to 37.9 million lines, compared to a 15% increase, from 28.2 million to 32.5 million lines, during the first half of the year.

- High-speed lines serving residential and small business subscribers increased by 36% during 2004, to 35.3 million lines. The increase was 17% during the second half of the year, from 30.1 million to 35.3 million lines, compared to a 16% increase, from 26.0 million to 30.1 million lines, during the first six months.

- During the year 2004, asymmetric digital subscriber line (ADSL) high-speed lines increased by 45%, to 13.8 million lines. They increased by 21% during the second half of 2004, from 11.4 million to 13.8 million lines, compared to a 20% increase, from 9.5 million to 11.4 million lines, during the preceding six months.

- High-speed coaxial cable connections (cable modem service) increased by 30% during 2004, to 21.4 million lines. They increased by 15% during the last six months of 2004, from 18.6 million to 21.4 million lines, compared to a 13% increase in the first half of the year, from 16.4 million to 18.6 million lines.

- The remaining 2.7 million high-speed connections in service at the end of 2004 were satellite or terrestrial wireless connections, fiber or powerline connections, or wireline connections other than ADSL. During 2004, satellite or terrestrial wireless connections increased by 50%, to 0.5 million, and fiber or powerline connections increased by 16%, to 0.7 million.

2) Advanced Services Lines

- Advanced services lines of all technology types increased by 42%, to 28.9 million lines, during the year 2004. They increased by 23% during the second half of 2004, from 23.5 million to 28.9 million lines, compared to a 15% increase during the first half of the year, from 20.3 million to 23.5 million lines.

- About 26.4 million of the 28.9 million advanced services lines served residential and small business subscribers.

- ADSL advanced services lines increased by 88% and cable modem advanced services lines increased by 36% during 2004. ADSL advanced services lines increased by 51% during the last six months of 2004, compared to a 19% increase for cable modem advanced services lines. During the first half of the year, ADSL advanced services lines increased by 24% and cable modem advanced services lines increased by 15%.

3) Geographic Coverage

- At the end of 2004, the service providers that report to the Commission had at least one high-speed service subscriber in 95% of the nation's zip codes. Our analysis indicates that 99% of the country's population lives in these zip codes.

The summary statistics released today also include state-by-state, population density, and household income information, ranked by zip codes. As additional information becomes available, it will be posted on the Commission's Internet site.

The report is available for reference in the FCC's Reference Information Center, Courtyard Level, 445 12th Street, SW, Washington, DC. Copies may be purchased by calling Best Copy and Printing, Inc. at (800) 378-3160. The report can also be downloaded from the **FCC-State Link** Internet site at www.fcc.gov/wcb/stats.

- FCC -

Wireline Competition Bureau contacts: James Eisner and Suzanne Mendez at (202) 418-0940, TTY (202) 418-0484.

High-Speed Services for Internet Access: Status as of December 31, 2004

Industry Analysis and Technology Division
Wireline Competition Bureau
July 2005

This report is available for reference in the FCC's Reference Information Center, Courtyard Level, 445 12th Street, SW, Washington, DC. Copies may be purchased by contacting Best Copy and Printing, Inc., 445 12th Street, SW, Room CY-B402, Washington, DC 20554, telephone (800) 378-3160, or via their website at www.bcpiweb.com. The report can also be downloaded from the **FCC-State Link** Internet site at www.fcc.gov/wcb/stats.

High-Speed Services for Internet Access: Status as of December 31, 2004

Congress directed the Commission and the states, in section 706 of the Telecommunications Act of 1996, to encourage deployment of advanced telecommunications capability in the United States on a reasonable and timely basis.[1] To assist in its evaluation of such deployment, the Commission instituted a formal data collection program to gather standardized information about subscribership to high-speed services, including advanced services, from wireline telephone companies, cable television providers, terrestrial wireless providers, satellite providers, and any other facilities-based providers of advanced telecommunications capability.[2]

We summarize here information from the eleventh data collection, thereby presenting a snapshot of subscribership as of December 31, 2004.[3] Subscribership to high-speed services for Internet access increased by 17% during the second half of 2004, to a total of 37.9 million lines in service. The presence of high-speed service subscribers was reported in all 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands, and in 95% of the zip codes in the United States.

Before presenting the most recent information in some detail, we provide a brief description of the Commission's data collection program to enable the reader to better understand how the nationwide information presented here may compare to similar information derived from other sources. First, for purposes of this report, we required facilities-based providers of high-speed connections to end users in a given state to report to the Commission basic information about their service offerings and customers if the provider has at least 250 high-speed lines (or wireless channels) in service in that state.[4] Although we encourage providers not meeting the reporting

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[1] *See* §706, Pub.L. 104-104, Title VII, Feb. 8, 1996, 110 Stat. 153, reproduced in the notes under 47 U.S.C. § 157. We use the term "high-speed" to describe services that provide the subscriber with transmissions at a speed in excess of 200 kilobits per second (kbps) in at least one direction. "Advanced services," which provide the subscriber with transmission speeds in excess of 200 kbps in each direction, are a subset of high-speed services.

[2] *Local Competition and Broadband Reporting*, CC Docket No. 99-301, Report and Order, 15 FCC Rcd 7717 (2000) (*Data Gathering Order*). During this data gathering program, qualifying providers file FCC Form 477 each year on March 1 (reporting data for the preceding December 31) and September 1 (reporting data for June 30 of the same year). An updated FCC Form 477, and instructions for that particular form, for each specific round of the data collection may be downloaded from the FCC Forms website at www.fcc.gov/formpage.html.

[3] Statistical summaries of the earlier Form 477 data collections appeared in *Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion*, CC Docket No. 98-146, Second Report, 15 FCC Rcd 20913 (2000) (*Second 706 Report*), available at www.fcc.gov/broadband/706.html, and in previous releases of the *High-Speed Services for Internet Access* report, available at www.fcc.gov/wcb/stats.

[4] We note that the Commission recently issued an Order that eliminated reporting thresholds. *See Local Telephone Competition and Broadband Reporting*, WC Docket No. 04-141, Report and Order, FCC 04-266 (rel. Nov. 12, 2004). Accordingly, beginning in September, 2005, data reported pursuant to Form 477 will not include thresholds. The reporting threshold of 250 high-speed lines (or wireless channels) is calculated based collectively on all commonly-owned and commonly-controlled affiliates operating in a given state, with a 10% equity interest as indicia of ownership. For reporting purposes, an entity is a facilities-based provider of high-speed service if it provides the service over its own "local loop" facilities connecting to end users, or over unbundled network elements (UNEs), special access lines, and other leased lines and wireless channels that it obtains from unaffiliated (continued….)

threshold to provide information on a voluntary basis, not all such providers have reported data.[5] In particular, we do not know how comprehensively small providers, many of whom serve rural areas with relatively small populations, are represented in the data summarized here. Second, we do not allow the reporting of lines (or wireless channels) that are not "high-speed" (i.e., delivering transmissions to the subscriber at a speed in excess of 200 kbps in at least one direction). Some asymmetric digital subscriber line (ADSL) services and Integrated Services Digital Network (ISDN) services provided by telephone companies and some services that connect subscribers to the Internet over cable systems do not meet this "high-speed" criterion, but may nevertheless meet the needs of the subscribers who select them.

Based on the latest information now available, readers can draw the following broad conclusions:

- Subscribership to high-speed services increased by 17% during the second half of 2004, to a total of 37.9 million lines (or wireless channels) in service. The increase during the first half of 2004 was 15%. See Table 1.

- High-speed ADSL lines in service increased by 21% during the second half of 2004, to 13.8 million lines. High-speed connections over coaxial cable systems (cable modem service) increased by 15%, to 21.4 million lines.[6] See Table 1.

- Reported high-speed connections to end users by means of satellite or terrestrial wireless technologies increased by 30% during the second half of 2004, and reported fiber optic and electric powerline connections to end-user premises increased by 9%. These technologies, together, accounted for about 1.2 million high-speed connections at the end of December 2004. See Table 1.

(Continued from previous page)
entities and equips to provide high-speed service. Non-facilities-based Internet Service Providers (ISPs), as such, have no reporting obligation. End-user lines equipped as high-speed service by, for example, an incumbent LEC must be reported by the incumbent LEC or an affiliate (assuming the LEC and its affiliates collectively have at least 250 such lines in service in a given state) irrespective of whether the end user of the retail high-speed Internet-access service is billed by the incumbent LEC, its ISP affiliate, another affiliate, or its billing agent, or by an unaffiliated ISP that has incorporated the incumbent LEC's high-speed service into a premium Internet-access service marketed under the ISP's own name.

[5] High-speed lines reported in recent voluntary submissions represent less than 0.05% of total high-speed lines reported.

[6] Providers are instructed to report a high-speed subscriber in the (mutually exclusive) technology category that characterizes the last few feet of distribution plant to the subscriber's premises, e.g., coaxial cable in the case of the hybrid fiber-coax (HFC) architecture of upgraded cable systems. As noted above, ADSL services that do not deliver over 200 kbps in at least one direction are not included in the data reported here. Symmetric DSL services at speeds exceeding 200 kbps are included in the "other wireline" category because they are typically used to provide data services that are functionally equivalent to the T-1 and other data services that wireline telephone companies have offered to business customers for some time.

- Subscribership to the subset of high-speed services that are described as advanced services (i.e., delivering to subscribers transmission speeds in excess of 200 kbps in each direction) increased by 23% during the second half of 2004, to a total of 28.9 million lines (or wireless channels) in service. Advanced services lines provided by means of ADSL technology increased by 51%, and advanced services lines provided over coaxial cable systems increased by 19%.[7] See Table 2.

- As of December 31, 2004, there were about 35.3 million high-speed lines serving residential and small business subscribers. By contrast, there were about 30.1 million such lines six months earlier, and about 26.0 million a year earlier. See Table 3.

- Of the 35.3 million high-speed lines in service to residential and small business subscribers at the end of December 2004, we estimate that about 26.4 million lines provide advanced services.[8] See Table 4.

- Among entities that reported facilities-based ADSL high-speed lines in service as of December 31, 2004, about 96% of such lines were reported by incumbent local exchange carriers (ILECs). ILECs claimed a smaller share, about 62%, of high-speed lines delivered over other traditional wireline facilities.[9] When all technologies are considered, ILECs provide about 38% of high-speed connections to end users. See Table 5.

- Providers of high-speed services over coaxial cable systems report serving subscribers in all 50 states, the District of Columbia, and Puerto Rico. Providers of high-speed ADSL services report serving subscribers in all 50 states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands, as do providers who use wireline technologies other than ADSL, or who use optical carrier (i.e., fiber) or electric powerline, satellite, or terrestrial wireless technologies in the last few feet to the subscriber's premises.[10] See Table 6.

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[7] Providers also estimate the percentage of high-speed connections that are faster than 2 mbps in both directions. About 0.4 million such connections were reported as of December 31, 2004. About 21% of these connections were reported in the other traditional wireline category and about 60% were reported in the optical carrier category.

[8] Filers of FCC Form 477 do not directly report the number of advanced services lines provided to residential and small business end users, as opposed to other end users. In estimating the number of advanced services lines serving residential and small business end users, we assume that reported advanced service lines were more likely to be delivered to large business users first and to residential and small business users second. *See also Second 706 Report*, 15 FCC Rcd 20943.

[9] Symmetric forms of DSL services, which are typically purchased by business customers, are included in this category.

[10] Information about providers of high-speed services other than ADSL and cable modem is reported in a single category, for the individual states, to honor requests for nondisclosure of information that reporting entities assert is competitively sensitive. In the *Data Gathering Order*, the Commission stated it would publish high-speed data only once it has been aggregated in a manner that does not reveal individual company data. *See Data Gathering Order*, 15 FCC Rcd 7760.

- The Commission's data collection program gathers from providers information about the number of high-speed lines in service in individual states, in total and by technology deployed in the last few feet to the subscriber's premises. Relatively large numbers of total high-speed lines in service are associated with the more populous states. As of December 31, 2004, the most populous state, California, had the largest reported number of high-speed lines. The second, third, and fourth largest numbers of high-speed lines were reported for New York, Florida, and Texas, which are the third, fourth, and second most populous states, respectively. See Table 7 and, for historical data, see Tables 8 - 10.

- Reporting entities estimate the percentage of their high-speed lines in service that connect to residential and small business end users (as opposed to connecting to medium and large business, institutional, or government end users).[11] These percentages allow us to derive approximate numbers of residential and small-business high-speed lines in service by state. See Table 11.

- The Commission's data collection program also requires service providers to identify each zip code in which the provider has at least one high-speed service subscriber. As of December 31, 2004, subscribers to high-speed services were reported in 95% of the nation's zip codes. In 83% of the nation's zip codes more than one provider reported having subscribers.[12] See Table 12.

- Our analysis indicates that 99% of the country's population lives in the 95% of zip codes where a provider reports having at least one high-speed service subscriber. Moreover, numerous competing providers report serving high-speed subscribers in the major population centers of the country. See the map that follows Table 12.

- States vary widely with respect to the percentage of zip codes in the state in which no high-speed lines are reported to be in service. See Table 13.

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[11] Reporting entities are instructed to consider a high-speed line as being provided to a "residential and small business" end user if that end user has a high-speed connection of a type (*e.g.*, speed and price) that is normally associated with residential end users.

[12] Lists of zip codes with number of service providers as reported in the FCC Form 477 filings are made available at www.fcc.gov/wcb/stats in a format that honors requests for nondisclosure of information the reporting entities assert is competitively sensitive.

- High population density has a positive association with reports that high-speed subscribers are present, and low population density has an inverse association. For example, as of December 31, 2004, high-speed subscribers are reported to be present in 99% of the most densely populated zip codes and in 75% of zip codes with the lowest population densities.[13] The comparable figure for the lowest-density zip codes was 74% a year earlier. See Table 14.

- High median household income also has a positive association with reports that high-speed subscribers are present. In the top one-tenth of zip codes ranked by median household income, high-speed subscribers are reported in 99% of zip codes. By contrast, high-speed subscribers are reported in 83% of zip codes with the lowest median household income, compared to 82% a year earlier. See Table 15.

As other information from the Commission's data collection program (FCC Form 477) becomes available, it will be included in future reports on the deployment of advanced telecommunications capability and in publications such as this one.

We invite users of this information to provide suggestions for improved data collection and analysis by:

- Using the attached customer response form,
- E-mailing comments to James.Eisner@fcc.gov or Suzanne.Mendez@fcc.gov,
- Calling the Industry Analysis and Technology Division of the Wireline Competition Bureau at (202) 418-0940, or
- Participating in any formal proceedings undertaken by the Commission to solicit comments for improvement of FCC Form 477.

[13] For this comparison, we consider the most densely populated zip codes to be those with more than 3,147 persons per square mile (the top decile of zip codes) and the least densely populated zip codes to be those with fewer than 6 persons per square mile (the bottom decile).

Table 1
High-Speed Lines [1]
(Over 200 kbps in at Least One Direction)

Types of Technology [2]	1999	2000		2001		2002		2003		2004		Percent Change	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Dec 2003 - Jun 2004	Jun 2004 - Dec 2004
ADSL	369,792	951,583	1,977,101	2,693,834	3,947,808	5,101,493	6,471,716	7,675,114	9,509,442	11,398,199	13,817,280	20 %	21 %
Other Wireline	609,909	758,594	1,021,291	1,088,066	1,078,597	1,186,680	1,216,208	1,215,713	1,305,070	1,407,121	1,468,566	8	4
Coaxial Cable	1,411,977	2,284,491	3,582,874	5,184,141	7,059,598	9,172,895	11,369,087	13,684,225	16,446,322	18,592,636	21,357,400	13	15
Fiber or Powerline	312,204	307,151	376,203	455,593	494,199	520,884	548,471	575,613	602,197	638,812	697,779	6	9
Satellite or Wireless	50,404	65,615	112,405	194,707	212,610	220,588	276,067	309,006	367,118	421,690	549,621	15	30
Total Lines	2,754,286	4,367,434	7,069,874	9,616,341	12,792,812	16,202,540	19,881,549	23,459,671	28,230,149	32,458,458	37,890,646	15 %	17 %

See notes following Chart 8.

Chart 1
Total High-Speed Lines

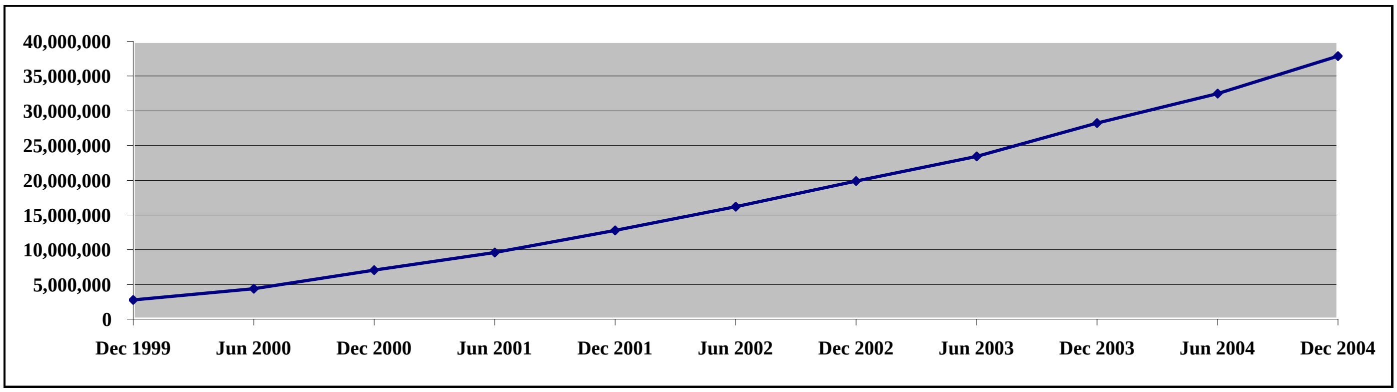


Chart 2
High-Speed Lines by Technology

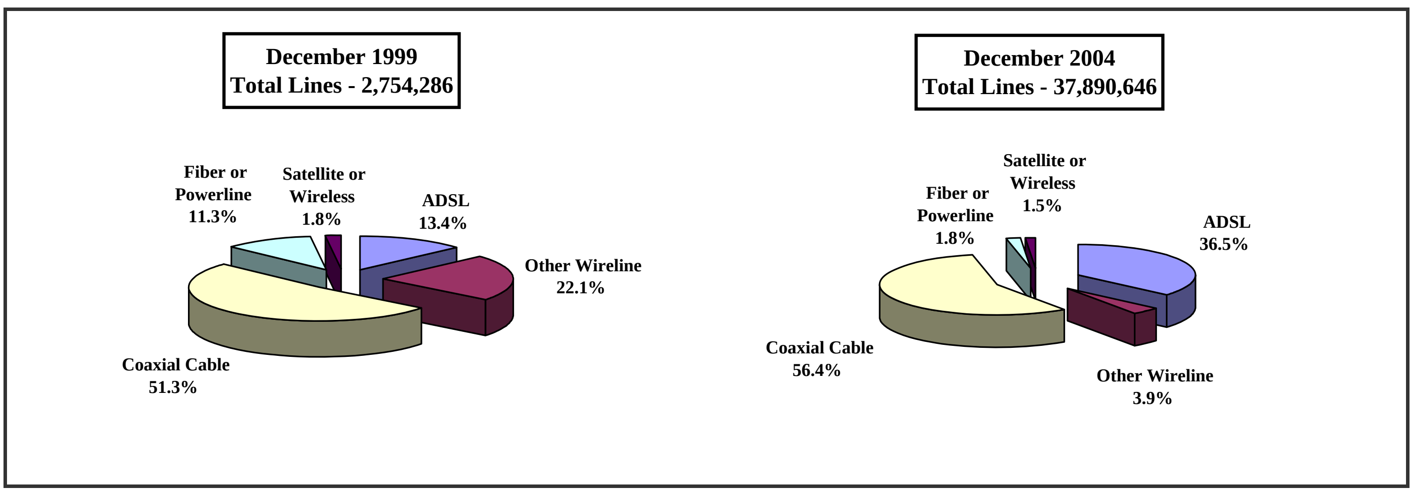


Table 2
Advanced Services Lines [1]
(Over 200 kbps in Both Directions)

Types of Technology [2]	1999	2000		2001		2002		2003		2004		Percent Change	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Dec 2003 - Jun 2004	Jun 2004 - Dec 2004
ADSL	185,950	326,816	675,366	998,883	1,369,143	1,852,879	2,178,394	2,536,368	3,037,474	3,768,019	5,695,548	24 %	51 %
Other Wireline	609,909	758,594	1,021,291	1,088,066	1,078,597	1,186,680	1,216,208	1,215,713	1,305,070	1,407,121	1,468,566	8	4
Coaxial Cable	877,465	1,469,130	2,193,609	3,329,976	4,394,778	6,819,395	8,342,234	11,935,866	15,327,247	17,567,468	20,891,624	15	19
Fiber or Powerline	307,315	301,143	376,197	455,549	486,483	518,908	548,123	575,057	601,441	637,520	695,253	6	9
Satellite or Wireless	7,816	3,649	26,906	73,476	75,341	66,073	65,929	64,393	73,222	93,805	106,616	28	14
Total Lines	1,988,455	2,859,332	4,293,369	5,945,950	7,404,343	10,443,935	12,350,888	16,327,396	20,344,453	23,473,932	28,857,608	15 %	23 %

See notes following Chart 8.

Chart 3
Advanced Services Lines

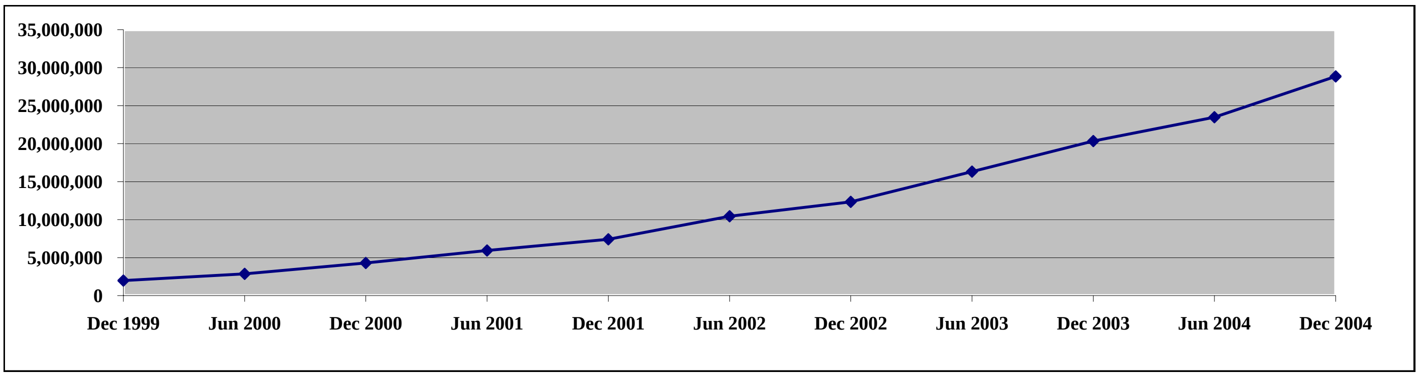


Chart 4
Advanced Services Lines by Technology

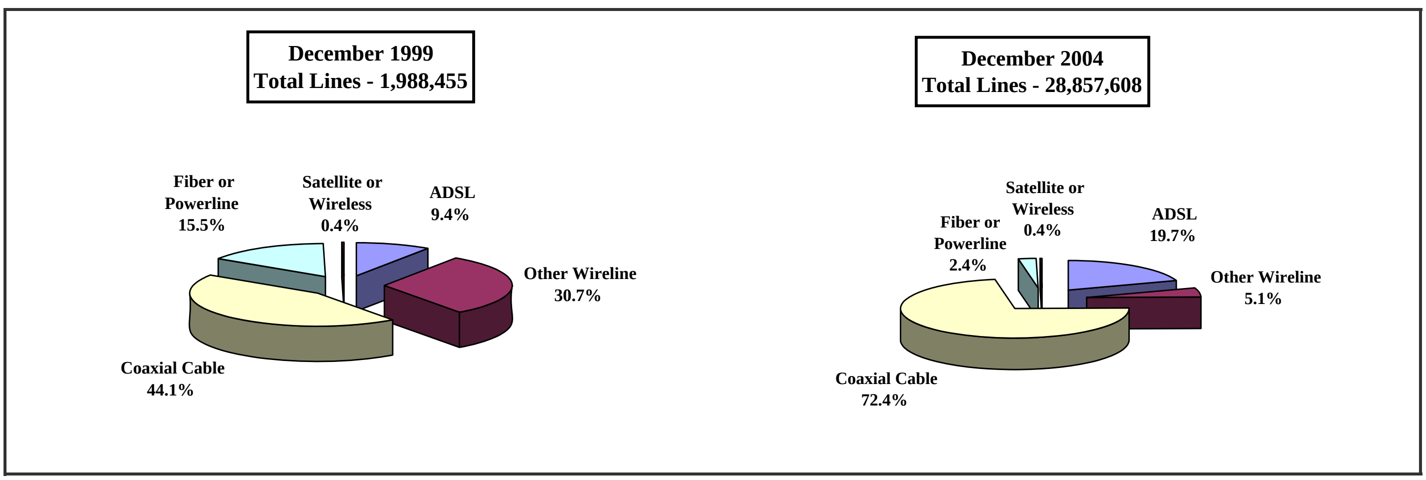


Table 3
Residential and Small Business High-Speed Lines [1]
(Over 200 kbps in at Least One Direction)

Types of Technology [2]	1999	2000		2001		2002		2003		2004		Percent Change	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Dec 2003 - Jun 2004	Jun 2003 - Dec 2004
ADSL	291,757	772,272	1,594,879	2,490,740	3,615,989	4,395,033	5,529,241	6,429,938	8,909,027	10,759,495	13,119,326	21 %	22 %
Other Wireline	46,856	111,490	176,520	138,307	139,660	223,599	213,489	250,372	289,764	393,049	419,215	36	7
Coaxial Cable	1,402,394	2,215,259	3,294,546	4,998,540	7,050,709	9,157,285	11,342,512	13,660,541	16,416,364	18,525,265	21,270,158	13	15
Fiber or Powerline	1,023	325	1,994	2,623	4,139	6,120	14,692	16,132	19,830	22,719	34,959	15	54
Satellite or Wireless	50,189	64,320	102,432	182,165	194,897	202,251	256,978	288,786	341,864	387,563	422,623	13	9
Total Lines	1,792,219	3,163,666	5,170,371	7,812,375	11,005,396	13,984,287	17,356,912	20,645,769	25,976,850	30,088,091	35,266,281	16 %	17 %

See notes following Chart 8.

Chart 5
Residential and Small Business High-Speed Lines

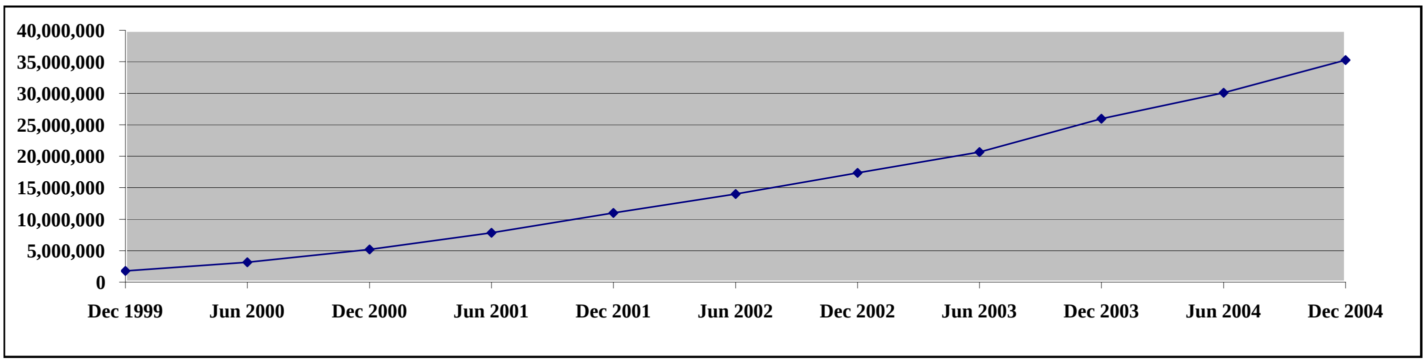


Chart 6
Residential and Small Business High-Speed Lines by Technology

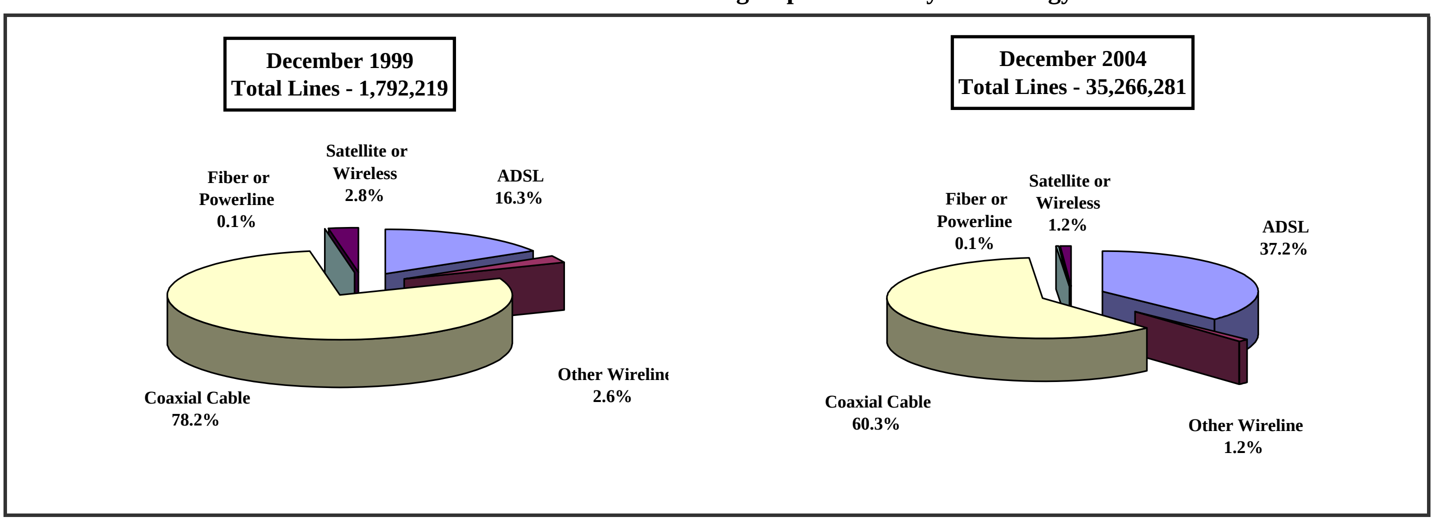


Table 4
Residential and Small Business Advanced Services Lines [1]
(Over 200 kbps in Both Directions)

Types of Technology [2]	1999	2000		2001		2002		2003		2004		Percent Change	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Dec 2003 - Jun 2004	Jun 2004 - Dec 2004
ADSL	116,994	195,324	393,246	916,364	1,243,996	1,580,575	1,827,547	2,071,779	2,437,059	3,174,022	5,026,367	30 %	58 %
Other Wireline	46,856	111,490	176,520	138,307	139,660	223,599	213,489	250,372	289,764	393,049	419,215	36	7
Coaxial Cable	872,024	1,401,434	2,177,328	3,146,953	4,388,967	6,809,170	8,322,157	11,920,207	15,297,289	17,505,907	20,811,704	14	19
Fiber or Powerline	138	325	1,992	2,617	3,523	5,118	14,408	15,751	19,074	21,866	33,189	15	52
Satellite or Wireless	7,682	2,916	17,043	60,988	58,113	47,787	47,903	46,407	51,944	72,485	84,465	40	17
Total Lines	1,043,694	1,711,488	2,766,130	4,265,229	5,834,258	8,666,249	10,425,505	14,304,515	18,095,131	21,167,329	26,374,940	17 %	25 %

See notes following Chart 8.

Chart 7
Residential and Small Business Advanced Services Lines

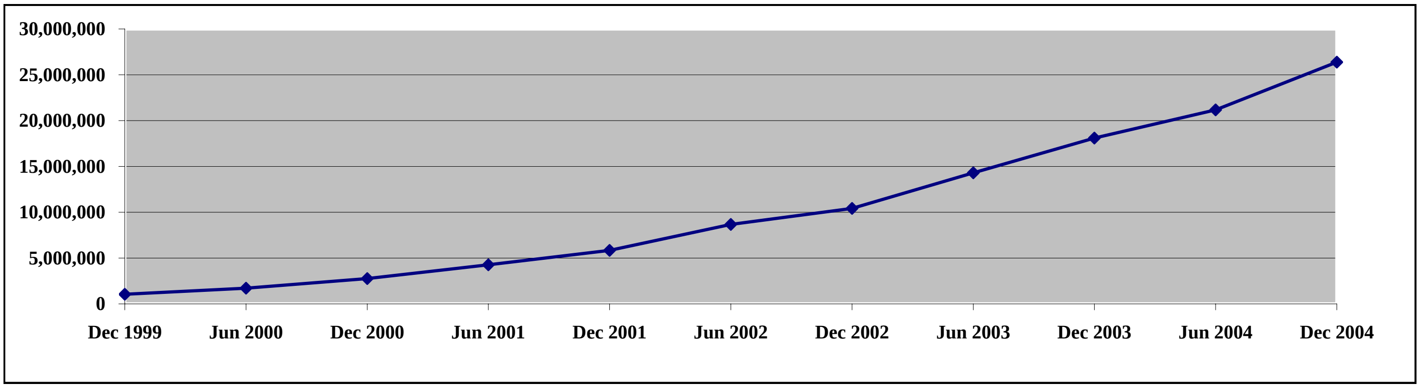
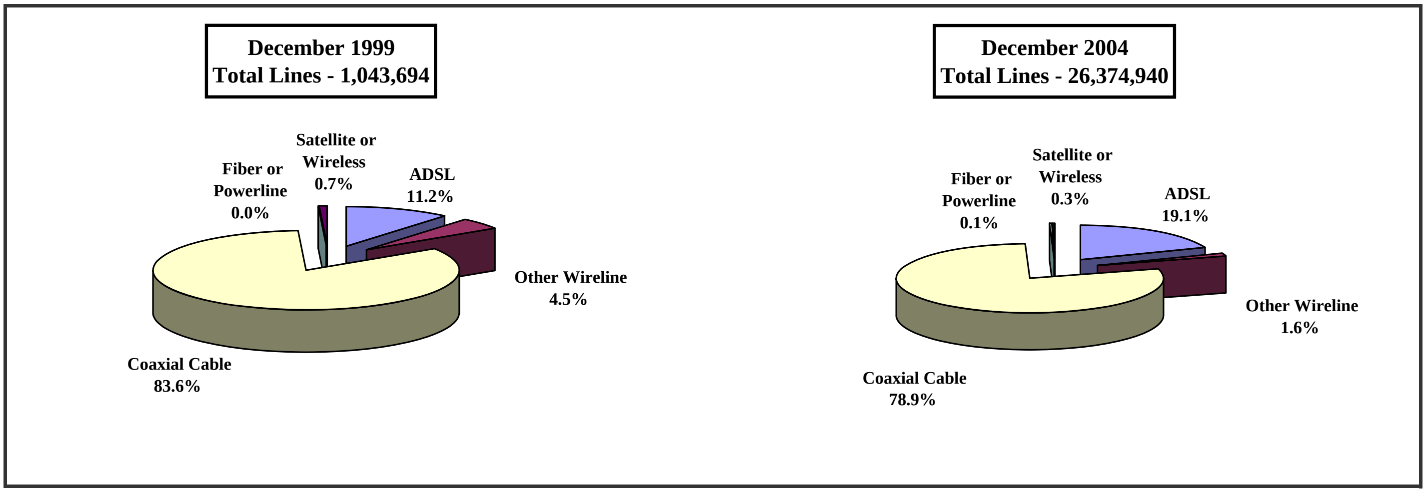


Chart 8
Residential and Small Business Advanced Services Lines by Technology



Notes for Tables 1 - 4 and Charts 1 - 8

Notes: Advanced services lines, residential and small business high-speed lines, and residential and small busine: advanced services lines are estimated based on data reported on FCC Form 477. Therefore, figures may not add to totals due to rounding.

[1] A high-speed line is a connection to an end-user customer that is faster than 200 kbps in at least one direction. Advanced services lines, which are a subset of high-speed lines, are connections to end-user customers that are faster than 200 kbps in both directions. The speed of the purchased service varies among end-user customers. For example, a high-speed service delivered to the end-user customer over other traditional wireline technology, such DS1 or DS3 service, or over optical fiber to the end user's premises may be much faster than the ADSL or cable modem service purchased by a different, or by the same, end user. Numbers of lines reported here are not adjusted for the speed of the service delivered over the line or the number of end users able to utilize the lines.

[2] The mutually exclusive types of technology are, respectively: Asymmetric digital subscriber line (ADSL) technologies, which provide speeds in one direction greater than speeds in the other direction; wireline technologies "other" than ADSL, including traditional telephone company high-speed services and symmetric DSL services that provide equivalent functionality; coaxial cable, including the typical hybrid fiber-coax (HFC) architecture of upgraded cable TV systems; optical fiber to the subscriber's premises (e.g., Fiber-to-the-Home, or FTTH) and electric powerline; and satellite and terrestrial wireless systems, which use radio spectrum to communicate with a radio transmitter.

Table 5
High-Speed Lines by Type of Provider as of December 31, 2004
(Over 200 kbps in at Least One Direction)

Types of Technology [1]	Lines				Percent of Lines		
	RBOC [2]	Other ILEC	Non-ILEC [3]	Total	RBOC [2]	Other ILEC	Non-ILEC [3]
ADSL	11,489,276	1,730,927	597,077	13,817,280	83.2 %	12.5 %	4.3 %
Other Wireline	714,809	199,853	553,904	1,468,566	48.7	13.6	37.7
Coaxial Cable	*	*	21,319,224	21,357,400	*	*	99.8
Other	*	*	1,163,357	1,247,400	*	*	93.3
Total Lines	12,283,907	1,973,177	23,633,562	37,890,646	32.4 %	5.2 %	62.4 %

* Data withheld to maintain firm confidentiality.

[1] The mutually exclusive types of technology are, respectively: Asymmetric digital subscriber line (ADSL) technologies, which provide speeds in one direction greater than speeds in the other direction; wireline technologies "other" than ADSL, including traditional telephone company high-speed services and symmetric DSL services that provide equivalent functionality; coaxial cable, including the typical hybrid fiber-coax (HFC) architecture of upgraded cable TV systems; optical fiber to the subscriber's premises (e.g., Fiber-to-the-Home, or FTTH); and satellite and terrestrial wireless systems, which use radio spectrum to communicate with a radio transmitter.

[2] RBOC lines include all high-speed lines reported by BellSouth, SBC, and Verizon, and all high-speed lines reported by Qwest in states in which Qwest has ILEC operations.

[3] High-speed lines reported by competitive local exchange carriers (CLECs) or cable TV operations that are affiliated with a local exchange carrier are included in Non-ILEC lines, except for any such lines that are included in RBOC lines.

Chart 9
Share of High-Speed Lines by Type of Provider

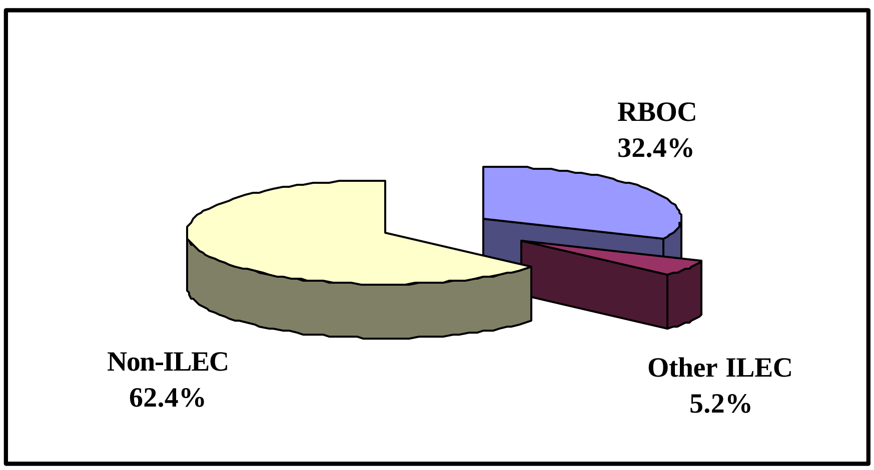


Table 6
Providers of High-Speed Lines by Technology as of December 31, 2004
(Over 200 kbps in at Least One Direction)

State	ADSL	Coaxial Cable	Other [1]	Total (Unduplicated)
Alabama	10	10	16	27
Alaska	5	*	7	8
American Samoa	0	0	0	0
Arizona	9	8	17	26
Arkansas	7	4	10	17
California	19	14	30	46
Colorado	9	5	16	22
Connecticut	6	6	12	18
Delaware	4	*	4	7
District of Columbia	5	*	8	10
Florida	14	10	28	39
Georgia	23	18	32	53
Guam	*	0	0	*
Hawaii	*	*	*	*
Idaho	8	*	12	17
Illinois	25	9	29	46
Indiana	18	10	23	35
Iowa	38	19	38	61
Kansas	19	16	25	41
Kentucky	12	10	13	30
Louisiana	11	6	15	22
Maine	7	4	7	15
Maryland	6	9	11	21
Massachusetts	7	7	14	21
Michigan	16	8	21	32
Minnesota	26	13	30	51
Mississippi	7	8	9	20
Missouri	15	12	21	37
Montana	12	4	11	20
Nebraska	16	9	18	29
Nevada	7	*	14	18
New Hampshire	6	5	10	17
New Jersey	7	5	13	18
New Mexico	9	5	10	16
New York	22	6	24	39
North Carolina	17	8	21	33
North Dakota	15	4	16	22
Ohio	16	14	28	38
Oklahoma	14	*	16	26
Oregon	18	5	19	29
Pennsylvania	21	13	23	41
Puerto Rico	*	*	*	5
Rhode Island	*	*	7	8
South Carolina	15	9	14	26
South Dakota	15	4	12	23
Tennessee	18	8	20	36
Texas	31	12	37	54
Utah	11	*	15	20
Vermont	6	*	8	11
Virgin Islands	*	0	*	*
Virginia	10	8	15	25
Washington	18	7	23	31
West Virginia	5	6	7	14
Wisconsin	31	6	21	40
Wyoming	4	*	7	8
Nationwide (Unduplicated) Dec 2004	352	147	312	552
Nationwide (Unduplicated) Jun 2004	298	129	281	485
Nationwide (Unduplicated) Dec 2003	274	110	246	432
Nationwide (Unduplicated) Jun 2003	235	98	217	378
Nationwide (Unduplicated) Dec 2002	178	87	169	299
Nationwide (Unduplicated) Jun 2002	142	68	138	237
Nationwide (Unduplicated) Dec 2001	117	59	122	203
Nationwide (Unduplicated) Jun 2001	86	47	98	160
Nationwide (Unduplicated) Dec 2000	68	39	87	136
Nationwide (Unduplicated) Jun 2000	47	36	75	116
Nationwide (Unduplicated) Dec 1999	28	43	65	105

* Data withheld to maintain firm confidentiality. In this table, an asterisk also indicates 1-3 providers reporting.

[1] Other includes wireline technologies other than asymmetric digital subscriber line (ADSL), optical fiber-to-the subscriber's premises, satellite, and terrestrial wireless systems.

Table 7
High-Speed Lines by Technology as of December 31, 2004
(Over 200 kbps in at Least One Direction)

State	ADSL	Coaxial Cable	Other [1]	Total
Alabama	135,282	233,004	41,768	410,054
Alaska	33,690	*	*	110,416
American Samoa	0	0	0	0
Arizona	136,260	549,613	65,009	750,882
Arkansas	100,987	106,055	13,282	220,324
California	2,700,380	2,213,138	469,331	5,382,849
Colorado	248,285	332,927	41,399	622,611
Connecticut	244,509	341,146	17,632	603,287
Delaware	16,490	*	*	92,889
District of Columbia	51,127	*	*	115,110
Florida	1,110,846	1,384,059	188,153	2,683,058
Georgia	636,170	468,027	124,913	1,229,110
Guam	*	0	0	*
Hawaii	*	*	*	*
Idaho	48,500	*	*	126,121
Illinois	707,771	691,214	135,668	1,534,653
Indiana	239,454	364,887	37,266	641,607
Iowa	88,707	163,293	14,794	266,794
Kansas	112,063	246,185	29,052	387,300
Kentucky	148,963	183,726	28,214	360,903
Louisiana	163,021	291,857	31,215	486,093
Maine	41,000	95,182	6,553	142,735
Maryland	249,379	501,144	45,587	796,110
Massachusetts	302,537	778,595	63,014	1,144,146
Michigan	299,861	733,511	63,858	1,097,230
Minnesota	188,181	404,135	59,618	651,934
Mississippi	71,993	80,210	16,768	168,971
Missouri	282,904	264,917	43,460	591,281
Montana	36,183	29,278	7,419	72,880
Nebraska	46,283	155,796	14,701	216,780
Nevada	93,145	*	*	343,945
New Hampshire	42,835	165,188	7,839	215,862
New Jersey	372,949	1,015,944	83,873	1,472,766
New Mexico	68,359	68,143	9,387	145,889
New York	641,321	1,976,663	190,569	2,808,553
North Carolina	340,520	691,904	88,187	1,120,611
North Dakota	23,874	17,307	6,776	47,957
Ohio	455,336	804,712	86,992	1,347,040
Oklahoma	158,490	*	*	391,781
Oregon	171,861	301,586	37,181	510,628
Pennsylvania	436,503	885,925	82,889	1,405,317
Puerto Rico	*	*	*	61,554
Rhode Island	*	*	4,851	165,362
South Carolina	128,042	252,646	35,156	415,844
South Dakota	18,357	14,103	7,826	40,286
Tennessee	193,879	386,258	50,171	630,308
Texas	1,104,776	1,320,225	172,538	2,597,539
Utah	113,033	*	*	238,205
Vermont	28,524	*	*	72,400
Virgin Islands	*	0	*	*
Virginia	254,355	681,914	61,992	998,261
Washington	338,321	498,934	52,113	889,368
West Virginia	39,566	108,585	7,246	155,397
Wisconsin	202,882	408,512	38,236	649,630
Wyoming	20,402	*	*	45,602
Nationwide	13,817,280	21,357,400	2,715,966	37,890,646

* Data withheld to maintain firm confidentiality.

[1] Other includes wireline technologies other than asymmetric digital subscriber line (ADSL), optical fiber-to-the subscriber's premises, satellite, and terrestrial wireless systems.

Table 8
High-Speed Lines by State
(Over 200 kbps in at Least One Direction)

State	1999	2000		2001		2002		2003		2004	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Alabama	19,796	32,756	63,334	86,234	138,979	172,365	227,888	283,946	352,215	350,691	410,054
Alaska	*	*	934	20,906	50,277	46,791	55,975	61,121	71,778	88,076	110,416
American Samoa	0	0	0	0	0	0	0	0	0	*	0
Arizona	58,825	111,678	153,500	158,122	251,709	308,621	370,939	445,179	536,465	623,242	750,882
Arkansas	8,155	15,539	28,968	40,803	66,537	84,235	100,280	128,311	158,197	188,433	220,324
California	547,179	910,006	1,386,625	1,705,814	2,041,276	2,598,491	3,035,756	3,456,681	4,165,658	4,693,189	5,382,849
Colorado	36,726	64,033	104,534	147,220	177,419	243,810	298,265	344,154	425,431	522,028	622,611
Connecticut	36,488	63,772	111,792	149,057	191,257	236,490	307,860	368,186	444,525	520,306	603,287
Delaware	1,558	3,660	7,492	12,771	26,601	36,619	51,100	55,030	69,010	75,593	92,889
District of Columbia	13,288	16,926	27,757	39,101	43,278	55,197	64,310	70,715	88,683	96,078	115,110
Florida	190,700	244,678	460,795	651,167	911,261	1,119,693	1,405,976	1,653,537	1,986,938	2,258,302	2,683,058
Georgia	75,870	130,292	203,855	302,598	420,206	512,135	654,833	768,060	927,398	1,061,819	1,229,110
Guam	0	0	0	0	0	0	0	0	0	*	*
Hawaii	*	*	*	*	*	*	*	*	*	*	*
Idaho	*	8,070	15,908	20,233	18,445	43,119	54,963	64,353	80,455	99,845	126,121
Illinois	77,672	166,933	242,239	350,241	422,706	553,442	734,171	871,469	1,088,770	1,305,091	1,534,653
Indiana	20,059	49,702	60,494	80,364	123,704	159,392	205,946	237,030	419,131	519,514	641,607
Iowa	19,258	49,159	58,199	72,583	82,024	102,932	121,053	162,257	191,464	229,811	266,794
Kansas	26,179	42,679	68,743	101,734	125,963	149,733	193,568	248,796	284,911	323,217	387,300
Kentucky	23,570	24,237	32,731	39,297	67,870	90,284	99,265	121,594	243,005	300,704	360,903
Louisiana	28,133	43,294	74,950	121,685	164,760	207,257	262,093	315,690	368,528	420,926	486,093
Maine	19,878	17,864	26,266	38,149	49,523	61,406	73,061	85,615	99,200	124,191	142,735
Maryland	52,749	71,005	124,465	181,021	260,634	316,666	391,397	469,826	578,004	668,259	796,110
Massachusetts	114,116	185,365	289,447	357,256	505,819	583,627	679,084	821,135	919,638	1,024,732	1,144,146
Michigan	81,223	135,318	198,230	395,583	433,858	538,416	640,766	736,755	848,837	955,242	1,097,230
Minnesota	38,268	65,272	117,283	148,012	199,856	273,907	335,562	400,370	485,839	567,365	651,934
Mississippi	*	6,514	12,305	21,517	35,586	57,595	80,922	96,111	116,495	139,960	168,971
Missouri	23,347	46,903	100,403	123,915	181,794	224,282	260,752	366,978	439,067	543,189	591,281
Montana	*	*	7,378	10,446	13,037	17,969	20,090	28,023	39,240	57,650	72,880
Nebraska	36,748	44,188	54,085	55,188	71,451	92,849	117,219	141,172	173,524	199,282	216,780
Nevada	23,514	40,582	59,879	78,535	109,850	138,042	159,179	209,732	247,442	291,291	343,945
New Hampshire	22,807	33,045	42,364	55,658	71,200	86,200	102,590	118,879	149,180	168,652	215,862
New Jersey	101,832	144,203	285,311	428,514	590,192	693,036	839,095	967,840	1,106,541	1,241,222	1,472,766
New Mexico	*	2,929	28,497	20,482	31,940	44,942	57,956	71,969	91,736	115,850	145,889
New York	186,504	342,743	603,487	893,032	1,199,159	1,460,894	1,725,296	1,997,340	2,262,804	2,464,342	2,808,553
North Carolina	57,881	81,998	136,703	205,616	357,906	461,736	594,039	681,304	842,130	966,404	1,120,611
North Dakota	*	2,437	4,227	6,277	6,082	14,164	20,024	25,474	31,571	39,274	47,957
Ohio	160,792	156,980	230,525	358,965	436,766	580,078	710,355	821,935	977,886	1,157,787	1,347,040
Oklahoma	96,730	163,703	95,138	92,947	114,931	151,213	196,556	234,823	286,510	335,686	391,781
Oregon	27,062	44,186	76,839	93,242	158,048	199,549	275,449	318,460	380,507	439,447	510,628
Pennsylvania	71,926	79,892	176,670	263,236	376,439	516,488	631,717	772,276	971,170	1,141,763	1,405,317
Puerto Rico	*	*	*	*	*	*	22,732	32,063	31,100	43,091	61,554
Rhode Island	*	20,628	30,919	49,215	64,293	72,553	89,821	105,610	122,255	143,250	165,362
South Carolina	25,229	32,824	63,914	96,839	135,165	175,088	222,980	262,868	310,906	354,877	415,844
South Dakota	*	3,516	2,839	5,448	9,585	12,555	18,060	22,016	28,557	34,026	40,286
Tennessee	66,307	87,317	122,391	152,510	237,401	294,573	369,370	414,713	471,341	535,899	630,308
Texas	152,518	276,087	522,538	646,839	840,665	1,050,511	1,349,628	1,610,935	1,924,664	2,246,862	2,597,539
Utah	11,635	19,612	35,970	55,103	72,977	93,928	121,744	135,007	162,905	198,346	238,205
Vermont	*	1,551	7,773	16,230	21,795	29,990	32,814	39,773	44,724	56,033	72,400
Virgin Islands	0	*	*	*	*	*	*	*	*	*	*
Virginia	51,305	72,436	139,915	212,808	292,772	360,722	463,455	567,513	716,839	833,302	998,261
Washington	71,930	118,723	195,628	227,066	335,667	422,348	485,063	577,378	672,247	775,027	889,368
West Virginia	*	1,835	6,498	16,697	32,848	58,209	78,980	90,173	100,937	127,283	155,397
Wisconsin	18,599	34,262	76,257	127,755	182,395	257,099	335,991	401,995	488,620	565,160	649,630
Wyoming	*	*	*	*	7,856	10,990	14,696	17,507	24,818	35,464	45,602
Nationwide	2,754,286	4,367,434	7,069,874	9,616,341	12,792,812	16,202,540	19,881,549	23,459,671	28,230,149	32,458,458	37,890,646

* Data withheld to maintain firm confidentiality.

Table 9
ADSL High-Speed Lines by State
(Over 200 kbps in at Least One Direction)

State	1999	2000		2001		2002		2003		2004	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Alabama	*	*	12,320	*	34,785	45,350	56,860	70,639	112,274	112,059	135,282
Alaska	0	0	0	*	7,975	11,337	14,295	14,013	17,184	20,686	33,690
American Samoa	0	0	0	0	0	0	0	0	0	0	0
Arizona	*	*	32,395	39,828	53,489	68,280	72,324	77,368	87,263	108,735	136,260
Arkansas	*	*	*	*	22,240	28,477	35,594	44,801	60,435	80,981	100,987
California	122,855	373,574	622,894	735,677	928,345	1,214,543	1,485,309	1,715,998	2,065,780	2,342,186	2,700,380
Colorado	*	*	42,810	52,617	70,615	100,197	113,040	126,189	155,137	201,523	248,285
Connecticut	*	*	22,348	30,142	41,261	61,093	100,722	124,742	167,439	204,034	244,509
Delaware	*	*	*	*	*	*	*	*	*	10,572	16,490
District of Columbia	*	*	*	16,313	*	28,723	35,466	39,471	44,440	44,231	51,127
Florida	*	37,806	115,133	170,702	306,015	391,188	521,623	644,621	786,275	928,402	1,110,846
Georgia	*	*	56,588	106,649	172,556	237,922	305,004	368,372	452,567	535,088	636,170
Guam	0	0	0	0	0	0	0	0	0	*	*
Hawaii	*	*	*	*	*	*	*	*	*	*	*
Idaho	*	*	*	*	13,643	16,108	17,930	19,382	24,503	35,166	48,500
Illinois	3,150	12,812	48,278	89,080	110,448	195,560	300,497	363,733	466,052	588,906	707,771
Indiana	*	*	6,442	2,375	22,385	36,685	63,463	85,968	129,341	179,942	239,454
Iowa	*	*	*	9,532	13,193	18,751	29,161	39,386	48,226	65,580	88,707
Kansas	0	*	14,281	*	23,564	28,713	39,315	50,839	68,044	88,246	112,063
Kentucky	5,690	*	16,327	20,256	43,191	55,454	55,254	75,316	94,126	119,709	148,963
Louisiana	*	*	22,788	37,444	58,019	73,120	86,359	100,919	116,047	136,406	163,021
Maine	0	*	*	6,877	*	*	8,432	11,052	17,785	31,577	41,000
Maryland	*	*	*	51,051	79,997	95,439	115,687	126,873	152,906	192,139	249,379
Massachusetts	*	15,802	53,700	82,699	125,630	147,139	181,426	207,344	230,333	253,576	302,537
Michigan	786	*	25,482	41,428	52,505	80,588	111,182	135,360	175,202	236,310	299,861
Minnesota	*	25,975	40,870	51,640	67,527	86,184	98,316	115,244	134,914	159,137	188,181
Mississippi	*	*	*	*	*	*	*	33,650	41,740	52,892	71,993
Missouri	*	*	38,759	53,250	68,186	84,642	114,861	138,046	182,119	233,916	282,904
Montana	*	*	1,760	2,842	4,272	7,108	6,549	13,119	19,417	28,238	36,183
Nebraska	*	*	*	9,293	13,637	11,547	16,117	18,285	25,599	35,180	46,283
Nevada	*	*	10,023	*	17,598	24,073	36,662	47,934	61,014	74,879	93,145
New Hampshire	*	*	3,339	5,651	9,618	11,781	14,630	17,823	23,555	31,843	42,835
New Jersey	*	*	59,332	102,430	151,829	172,472	197,615	211,540	251,754	301,789	372,949
New Mexico	*	*	*	7,578	*	18,224	22,607	26,948	36,546	51,375	68,359
New York	9,307	41,656	124,146	197,135	285,814	338,229	391,686	438,241	497,071	536,980	641,321
North Carolina	*	8,662	23,815	41,332	65,582	89,680	124,031	161,642	210,958	264,248	340,520
North Dakota	*	*	*	*	4,849	6,575	8,826	11,593	14,034	19,412	23,874
Ohio	*	33,603	55,046	87,567	112,527	151,612	205,140	243,689	303,969	369,386	455,336
Oklahoma	*	*	*	31,321	39,978	50,617	65,378	78,248	106,031	129,996	158,490
Oregon	*	19,989	31,644	25,877	57,899	68,747	82,555	95,654	117,253	142,483	171,861
Pennsylvania	7,377	18,313	60,083	89,595	136,829	162,258	200,501	230,322	284,870	346,720	436,503
Puerto Rico	0	0	0	*	*	*	*	*	*	*	*
Rhode Island	0	*	*	*	*	*	*	*	*	*	*
South Carolina	*	*	5,168	9,704	18,686	26,184	38,293	52,667	77,599	98,583	128,042
South Dakota	*	*	*	1,652	2,869	4,389	6,308	8,637	11,635	15,230	18,357
Tennessee	*	*	13,705	22,902	42,571	57,984	74,034	92,777	116,785	147,922	193,879
Texas	*	73,117	158,513	197,668	300,752	368,796	486,833	597,447	772,697	930,997	1,104,776
Utah	*	*	17,352	23,476	33,306	47,637	57,025	65,648	76,466	95,656	113,033
Vermont	0	*	*	*	*	9,409	12,062	15,072	18,646	22,519	28,524
Virgin Islands	0	0	0	*	*	*	*	*	*	*	*
Virginia	7,425	9,510	26,750	39,114	65,298	75,524	96,805	114,797	144,584	196,568	254,355
Washington	*	52,345	79,130	64,812	140,273	172,652	200,189	225,377	262,149	300,804	338,321
West Virginia	0	*	*	*	*	*	*	*	*	*	39,566
Wisconsin	*	1,063	8,623	17,800	28,233	42,052	64,521	84,100	120,236	159,167	202,882
Wyoming	*	*	*	*	*	*	*	5,503	8,467	13,510	20,402
Nationwide	369,792	951,583	1,977,101	2,693,834	3,947,808	5,101,493	6,471,716	7,675,114	9,509,442	11,398,199	13,817,280

* Data withheld to maintain firm confidentiality.

Table 10
Coaxial Cable High-Speed Lines by State
(Over 200 kbps in at Least One Direction)

State	1999	2000		2001		2002		2003		2004	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Alabama	8,415	17,164	36,432	47,325	83,933	104,990	144,259	181,338	207,397	206,208	233,004
Alaska	0	0	0	0	*	*	*	*	*	*	*
American Samoa	0	0	0	0	0	0	0	0	0	0	0
Arizona	*	*	*	*	151,916	194,431	251,373	319,272	396,960	457,869	549,613
Arkansas	*	*	*	*	*	*	*	*	86,441	95,528	106,055
California	221,472	297,415	476,544	609,174	786,789	1,013,503	1,179,204	1,395,435	1,706,217	1,929,080	2,213,138
Colorado	*	*	*	*	*	*	*	181,766	231,075	280,909	332,927
Connecticut	28,702	47,127	78,234	106,019	137,003	160,913	192,155	227,658	260,415	299,176	341,146
Delaware	*	*	*	*	*	*	*	*	*	*	*
District of Columbia	*	*	*	*	*	*	*	*	*	*	*
Florida	110,000	129,830	255,978	372,190	486,977	595,806	741,426	867,513	1,050,062	1,171,641	1,384,059
Georgia	18,114	48,947	75,474	109,922	156,142	183,886	243,142	289,922	361,127	407,038	468,027
Guam	0	0	0	0	0	0	0	0	0	0	0
Hawaii	*	*	*	*	0	*	*	*	*	*	*
Idaho	0	*	*	*	*	*	*	*	*	*	*
Illinois	*	83,737	126,490	144,872	204,202	242,394	316,169	383,069	494,110	589,025	691,214
Indiana	7,412	33,431	37,052	56,441	78,837	98,414	114,237	122,338	257,023	304,866	364,887
Iowa	14,027	42,081	48,008	59,253	63,788	77,592	83,994	111,748	131,073	151,299	163,293
Kansas	*	*	48,541	74,337	94,047	111,615	142,563	181,437	199,369	209,233	246,185
Kentucky	*	*	*	*	*	12,867	22,113	23,672	124,535	154,567	183,726
Louisiana	*	*	*	64,219	88,851	115,198	*	189,920	227,047	257,405	291,857
Maine	*	*	*	*	*	*	*	*	*	*	95,182
Maryland	*	42,412	65,668	97,466	143,174	181,864	241,264	306,442	385,408	433,754	501,144
Massachusetts	*	148,233	210,019	243,670	339,244	391,391	453,473	564,961	638,441	704,956	778,595
Michigan	51,111	94,586	130,296	301,842	329,697	402,642	472,405	543,336	611,131	656,263	733,511
Minnesota	14,346	30,485	64,215	80,259	113,900	166,323	212,126	255,988	317,853	358,477	404,135
Mississippi	*	*	*	*	12,998	27,872	40,276	50,234	61,163	72,271	80,210
Missouri	*	16,482	42,255	51,733	89,370	110,026	117,403	191,658	221,917	266,493	264,917
Montana	0	*	*	*	*	*	*	*	*	22,856	29,278
Nebraska	*	*	*	37,168	49,939	73,306	92,261	111,903	130,319	142,555	155,796
Nevada	*	*	*	*	*	*	*	*	*	*	*
New Hampshire	*	*	*	*	*	*	*	95,612	118,456	129,024	165,188
New Jersey	*	*	*	*	375,362	454,750	578,337	690,620	781,898	862,834	1,015,944
New Mexico	0	0	*	*	*	*	*	38,004	47,721	56,369	68,143
New York	110,382	*	377,521	564,423	780,473	967,949	1,185,233	1,401,322	1,597,556	1,752,189	1,976,663
North Carolina	24,200	42,713	73,092	115,949	239,107	313,884	406,024	454,272	559,276	623,414	691,904
North Dakota	0	*	*	*	*	*	*	10,066	13,030	14,428	17,307
Ohio	*	*	127,692	213,606	264,031	363,675	435,404	508,458	597,442	709,145	804,712
Oklahoma	*	*	*	*	*	*	*	*	*	*	*
Oregon	*	*	*	*	*	*	165,343	197,794	233,737	262,513	301,586
Pennsylvania	34,878	38,340	85,104	131,119	190,915	300,840	376,611	482,471	621,381	724,101	885,925
Puerto Rico	0	0	0	0	0	0	*	*	*	*	*
Rhode Island	*	*	*	*	*	*	*	*	*	*	*
South Carolina	15,176	20,190	44,812	68,487	96,559	126,598	159,944	185,083	209,889	228,648	252,646
South Dakota	0	*	*	*	*	*	7,916	9,156	11,042	12,114	14,103
Tennessee	*	*	77,760	96,119	158,120	199,121	252,596	277,579	308,630	340,883	386,258
Texas	76,520	137,670	227,070	328,900	427,324	577,233	740,469	888,595	1,019,623	1,162,797	1,320,225
Utah	*	*	*	*	*	*	*	*	*	*	*
Vermont	*	*	*	*	*	*	*	*	*	*	*
Virgin Islands	0	0	0	0	0	0	0	0	0	0	0
Virginia	23,140	40,337	78,585	131,553	182,591	238,300	320,154	404,616	517,924	579,580	681,914
Washington	*	*	*	*	*	217,644	246,627	313,915	367,321	426,487	498,934
West Virginia	*	*	*	*	*	48,858	65,542	73,263	78,018	97,463	108,585
Wisconsin	*	*	*	*	*	189,585	243,043	287,519	334,394	371,106	408,512
Wyoming	0	0	*	*	*	*	*	*	*	*	*
Nationwide	1,411,977	2,284,491	3,582,874	5,184,141	7,059,598	9,172,895	11,369,087	13,684,225	16,446,322	18,592,636	21,357,400

* Data withheld to maintain firm confidentiality.

Table 11
High-Speed Lines by Type of User as of December 31, 2004
(Over 200 kbps in at Least One Direction)

State	Residential and Small Business	Other [1]	Total
Alabama	359,864	50,190	410,054
Alaska	101,039	9,377	110,416
American Samoa	0	0	0
Arizona	698,728	52,154	750,882
Arkansas	211,329	8,995	220,324
California	4,971,879	410,970	5,382,849
Colorado	582,282	40,329	622,611
Connecticut	580,566	22,721	603,287
Delaware	90,180	2,709	92,889
District of Columbia	92,498	22,612	115,110
Florida	2,438,390	244,668	2,683,058
Georgia	1,043,387	185,723	1,229,110
Guam	*	*	*
Hawaii	*	*	*
Idaho	122,672	3,449	126,121
Illinois	1,409,019	125,634	1,534,653
Indiana	606,470	35,137	641,607
Iowa	256,744	10,050	266,794
Kansas	372,647	14,653	387,300
Kentucky	323,532	37,371	360,903
Louisiana	444,600	41,493	486,093
Maine	138,111	4,624	142,735
Maryland	758,628	37,482	796,110
Massachusetts	1,096,029	48,117	1,144,146
Michigan	1,040,825	56,405	1,097,230
Minnesota	620,226	31,708	651,934
Mississippi	149,737	19,234	168,971
Missouri	542,502	48,779	591,281
Montana	69,056	3,824	72,880
Nebraska	204,724	12,056	216,780
Nevada	316,593	27,352	343,945
New Hampshire	208,738	7,124	215,862
New Jersey	1,391,005	81,761	1,472,766
New Mexico	137,842	8,047	145,889
New York	2,622,854	185,699	2,808,553
North Carolina	1,025,309	95,302	1,120,611
North Dakota	46,899	1,058	47,957
Ohio	1,249,482	97,558	1,347,040
Oklahoma	374,533	17,248	391,781
Oregon	489,569	21,059	510,628
Pennsylvania	1,328,814	76,503	1,405,317
Puerto Rico	59,570	1,984	61,554
Rhode Island	160,718	4,644	165,362
South Carolina	378,228	37,616	415,844
South Dakota	38,852	1,434	40,286
Tennessee	569,448	60,860	630,308
Texas	2,442,465	155,074	2,597,539
Utah	225,889	12,316	238,205
Vermont	69,939	2,461	72,400
Virgin Islands	*	*	*
Virginia	948,732	49,529	998,261
Washington	848,165	41,203	889,368
West Virginia	151,163	4,234	155,397
Wisconsin	616,281	33,349	649,630
Wyoming	29,015	16,587	45,602
Nationwide	35,266,281	2,624,365	37,890,646

* Data witheld to maintain firm confidentiality.

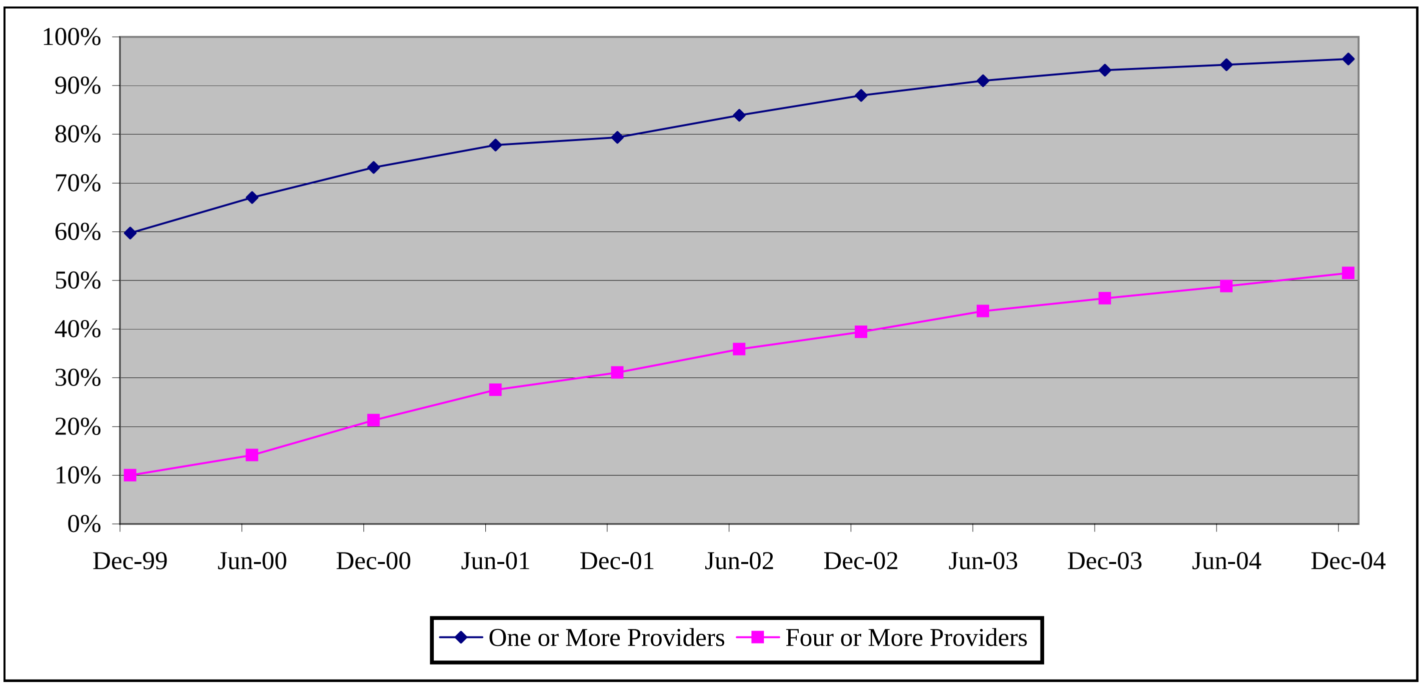
[1] Other includes medium and large business, institutional, and government customers.

Table 12
Percentage of Zip Codes with High-Speed Lines in Service

Number of Providers	1999	2000		2001		2002		2003		2004	
	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Zero	40.3 %	33.0 %	26.8 %	22.2 %	20.6 %	16.1 %	12.0 %	9.0 %	6.8 %	5.7 %	4.6 %
One	26.0	25.9	22.7	20.3	19.3	18.4	17.3	16.4	14.9	13.8	12.5
Two	15.5	17.8	18.4	16.7	15.7	16.2	16.8	16.9	17.1	16.8	16.3
Three	8.2	9.2	10.9	13.2	13.1	13.3	14.4	14.0	14.9	14.9	15.1
Four	4.3	4.9	6.1	8.2	9.1	9.6	10.3	10.6	11.2	11.6	12.2
Five	2.7	3.4	4.0	4.9	6.1	6.9	7.3	7.7	7.8	8.4	8.9
Six	1.7	2.5	3.0	3.6	4.2	4.6	5.0	5.3	5.8	6.1	6.3
Seven	0.8	1.7	2.3	2.8	3.2	3.2	3.9	4.0	4.2	4.4	4.6
Eight	0.3	0.8	2.0	2.2	2.5	2.8	2.7	3.1	3.3	3.6	3.6
Nine	0.2	0.4	1.6	1.9	2.0	2.4	2.2	2.5	2.6	2.8	3.1
Ten or More	0.0	0.4	2.4	3.9	4.0	6.4	8.0	10.5	11.4	11.8	12.8

Note: Figures may not add up to 100% due to rounding.

Chart 10
Percent of Zip Codes with High-Speed Providers



High-Speed Providers by ZIP Code

(As of December 31, 2004)

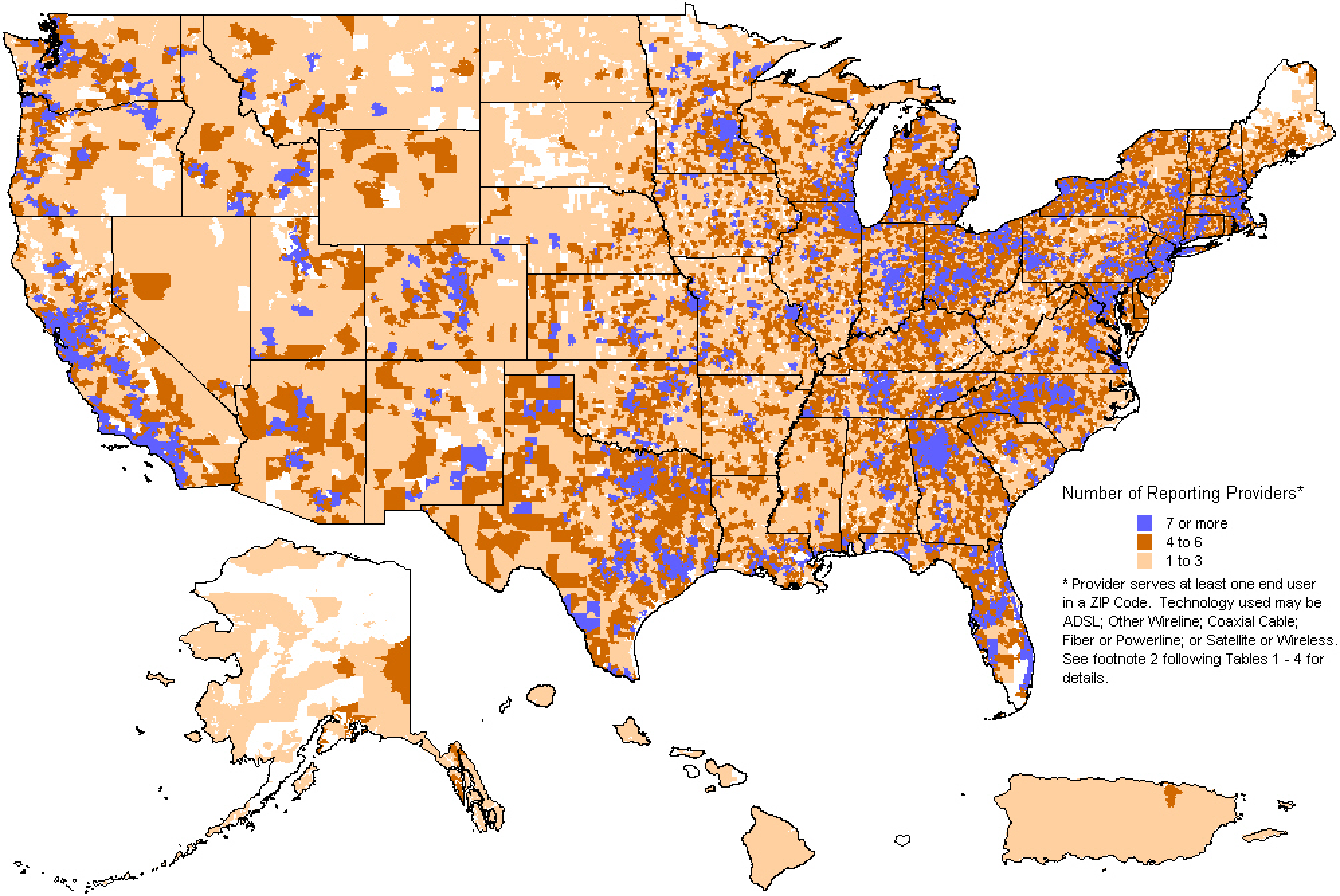


Table 13
Percentage of Zip Codes with High-Speed Lines in Service as of December 31, 2004
(Over 200 kbps in at Least One Direction)

	Number of Providers										
	Zero	**One**	**Two**	**Three**	**Four**	**Five**	**Six**	**Seven**	**Eight**	**Nine**	**Ten or More**
Alabama	7 %	13 %	15 %	18 %	17 %	9 %	5 %	5 %	4 %	3 %	5 %
Alaska	4	30	45	12	9	0	0	0	0	0	0
Arizona	1	4	17	14	9	5	7	4	5	4	29
Arkansas	10	23	27	17	11	5	4	2	2	0	0
California	1	5	10	11	9	4	4	4	4	5	42
Colorado	3	13	20	13	9	5	6	5	2	3	21
Connecticut	0	0	9	14	17	12	10	9	6	7	15
Delaware	2	0	5	16	48	16	14	0	0	0	0
District of Columbia	0	4	8	0	0	0	8	8	8	32	32
Florida	1	1	4	9	12	9	8	6	7	5	37
Georgia	1	5	11	16	15	13	8	7	3	2	19
Hawaii	10	10	32	48	0	0	0	0	0	0	0
Idaho	7	23	27	14	8	5	5	8	3	0	0
Illinois	3	13	17	16	12	7	5	4	2	3	17
Indiana	2	12	17	18	15	11	7	5	3	3	7
Iowa	14	24	21	15	10	8	4	3	1	0	0
Kansas	10	25	20	12	9	5	5	3	5	2	4
Kentucky	10	19	21	16	13	8	7	5	2	0	0
Louisiana	2	10	21	20	14	9	8	5	3	3	5
Maine	6	14	21	24	24	6	3	0	0	0	0
Maryland	1	7	12	12	12	11	7	4	4	5	25
Massachusetts	0	1	7	16	15	12	7	7	6	6	22
Michigan	1	5	11	16	14	15	9	6	5	3	14
Minnesota	10	16	16	14	11	8	4	3	2	2	13
Mississippi	3	17	25	25	10	7	8	4	1	1	0
Missouri	10	19	21	15	8	6	4	4	4	4	6
Montana	13	29	28	16	4	2	2	3	2	1	0
Nebraska	10	24	28	18	9	7	4	1	0	0	0
Nevada	2	20	16	8	8	4	16	11	2	5	8
New Hampshire	0	4	10	15	23	15	11	4	5	5	7
New Jersey	0	2	6	10	11	13	7	10	9	11	20
New Mexico	10	25	29	14	6	6	1	2	4	4	0
New York	0	4	9	13	16	14	9	6	5	4	19
North Carolina	1	4	14	19	18	13	8	5	4	2	12
North Dakota	15	49	29	3	2	2	0	0	0	0	0
Ohio	1	2	7	14	16	15	13	9	6	4	14
Oklahoma	6	19	20	14	10	8	6	7	7	2	1
Oregon	4	11	19	19	11	9	3	4	4	4	11
Pennsylvania	3	12	15	14	11	11	6	5	4	2	15
Puerto Rico	0	3	39	45	13	0	0	0	0	0	0
Rhode Island	1	4	9	12	19	19	19	16	0	0	0
South Carolina	3	14	18	15	11	15	11	8	5	1	0
South Dakota	22	32	25	12	5	3	1	0	0	0	0
Tennessee	3	8	17	16	13	11	7	7	4	3	11
Texas	2	8	12	12	13	12	9	6	5	3	19
Utah	7	14	22	12	9	2	5	3	2	3	23
Vermont	1	7	24	24	15	15	13	2	0	0	0
Virginia	3	16	14	20	14	8	5	3	3	4	10
Washington	2	10	17	16	10	5	6	4	5	5	20
West Virginia	12	34	24	12	10	4	3	1	0	0	0
Wisconsin	2	12	21	21	14	9	4	3	3	4	7
Wyoming	4	21	34	27	7	6	0	0	0	0	0
Nationwide	5 %	12 %	16 %	15 %	12 %	9 %	6 %	5 %	4 %	3 %	13 %

Table 14
High-Speed Subscribership
Ranked by Population Density

Persons per Square Mile [1]	Percentage of Zip Codes with at Least One High-Speed Subscriber					Percentage of Population that Resides in Zip Codes with High-Speed Service				
	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004
More Than 3,147	98.2 %	98.1 %	98.7 %	98.9 %	99.1 %	99.9 %	99.8 %	100.0 %	100.0 %	100.0 %
947-3,147	97.1	97.3	98.2	98.5	98.7	99.8	99.7	100.0	99.9	99.9
268-947	95.7	95.8	97.9	98.8	99.1	99.3	99.5	99.9	100.0	100.0
118-268	91.5	93.3	96.7	97.9	98.2	98.1	99.1	99.7	99.8	99.8
67-118	85.9	89.3	95.0	97.5	98.0	95.0	97.1	99.1	99.7	99.7
41-67	76.1	83.3	91.5	96.0	97.5	87.9	94.4	97.8	99.0	99.3
25-41	65.0	73.1	87.6	92.6	95.5	80.0	87.6	95.6	97.7	98.5
15-25	50.1	61.2	77.8	88.0	91.4	69.4	80.4	90.8	95.7	96.8
6-15	38.5	52.1	69.4	82.7	86.2	61.9	76.2	86.4	93.2	95.0
Fewer Than 6	27.5	43.3	59.7	73.5	74.8	49.9	67.9	80.9	88.9	91.8

Table 15
High-Speed Subscribership
Ranked by Household Income

Median Household Income [1]	Percentage of Zip Codes with at Least One High-Speed Subscriber					Percentage of Population that Resides in Zip Codes with High-Speed Service				
	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004	Dec 2000	Dec 2001	Dec 2002	Dec 2003	Dec 2004
$53,494 to $291,938	96.1 %	96.8 %	98.3 %	98.7 %	98.8 %	99.8 %	99.6 %	99.9 %	99.9 %	99.8 %
$43,617 to $53,478	88.9	91.7	95.3	97.4	97.6	99.0	99.3	99.8	99.9	99.9
$38,396 to $43,614	79.5	84.9	92.1	96.0	96.7	97.8	98.6	99.5	99.8	99.8
$34,744 to $38,395	74.5	79.9	88.2	94.0	95.0	96.6	97.6	99.1	99.6	99.7
$32,122 to $34,743	71.2	78.2	87.1	92.5	94.3	95.9	97.6	98.9	99.4	99.6
$29,893 to $32,121	67.4	75.5	85.6	91.8	93.8	94.5	96.8	98.5	99.3	99.4
$27,542 to $29,892	66.9	75.2	85.4	91.8	93.6	93.8	96.5	98.3	99.2	99.4
$24,855 to $27,541	65.1	71.8	83.2	89.8	92.6	93.1	95.6	98.1	98.9	99.2
$21,645 to $24,855	61.2	70.0	83.1	90.1	92.9	91.1	95.0	97.9	99.0	99.3
$0 to $21,644	54.9	62.7	74.5	81.9	83.3	91.5	95.1	97.5	98.6	99.0

[1] Persons per-square mile and median household income are in decile groups. Each groups contains 10% of the zip codes.

Customer Response

Publication: *High-Speed Services for Internet Access: Status as of December 31, 2004*

You can help us provide the best possible information to the public by completing this form and returning it to the Industry Analysis and Technology Division of the FCC's Wireline Competition Bureau.

1. Please check the category that best describes you:
   - ____ press
   - ____ current telecommunications carrier
   - ____ potential telecommunications carrier
   - ____ business customer evaluating vendors/service options
   - ____ consultant, law firm, lobbyist
   - ____ other business customer
   - ____ academic/student
   - ____ residential customer
   - ____ FCC employee
   - ____ other federal government employee
   - ____ state or local government employee
   - ____ Other (please specify)

2\.

Please rate the report:	Excellent	Good	Satisfactory	Poor	No opinion
Data accuracy	(_)	(_)	(_)	(_)	(_)
Data presentation	(_)	(_)	(_)	(_)	(_)
Timeliness of data	(_)	(_)	(_)	(_)	(_)
Completeness of data	(_)	(_)	(_)	(_)	(_)
Text clarity	(_)	(_)	(_)	(_)	(_)
Completeness of text	(_)	(_)	(_)	(_)	(_)

3\.

Overall, how do you rate this report?	Excellent	Good	Satisfactory	Poor	No opinion
	(_)	(_)	(_)	(_)	(_)

4. How can this report be improved?

5. May we contact you to discuss possible improvements?
   Name:
   Telephone #:

<table>
<tr><td colspan="3">To discuss the information in this report, contact: 202-418-0940
or for users of TTY equipment, call 202-418-0484</td></tr>
<tr><td>Fax this response to</td><td rowspan="2">or</td><td>Mail this response to</td></tr>
<tr><td>202-418-0520</td><td>FCC/WCB/IATD
Mail Stop 1600 F
Washington, DC 20554</td></tr>
</table>

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Robert J. Kenney
Title: Executive Director - Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-28 Please refer to page 8 and Footnotes No. 11 and No. 12 to Mr. Kenney's pre-filed direct testimony. Please provide a complete and legible copy of each report to which Mr. Kenney refers in those footnotes.

REPLY: The requested information is proprietary and competitively sensitive in nature, and is being furnished to the Division in accordance with the terms of the Protective Agreement between Verizon and the Division of Public Utilities and Carriers.

Please see the proprietary attachments.

VZ # 28

Verizon New England Inc.
d/b/a Verizon Rhode Island

State of Rhode Island

Docket No. 3692

Respondent: Robert J. Kenney
Title: Executive Director - Regulatory

REQUEST: Division of Public Utilities Set 1

DATED: September 9, 2005

ITEM: DIV 1-29 With reference to the Rhode Island wireless competition data that is cited at page 9, lines 7-11 and at Footnote No. 13 to Mr. Kenney's pre-filed direct testimony. Please provide a schedule that shows, or each period depicted at the table referenced in the footnote, the breakdown of total wireless subscribers in Rhode Island as between Verizon wireless subscribers and subscribers of all other wireless providers.

REPLY: Objection: Verizon RI objects to DIV 1-29 on the grounds that the information sought is irrelevant in establishing a retail alternative regulation plan and is not reasonably calculated to lead to the discovery of admissible evidence. Subject to such objection, Verizon RI states that it does not have the information requested.